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ABSTRACT

This document presents hearing testimony and prepared statements, letters, and supplemental material concerning the use of the United States tax collection system for collecting postsecondary education student loans and developing a repayment system that is income-sensitive. Among those presenting testimony are the following: Michael S. Bigelow, Deputy Assistant Commissioner, Returns Processing, Internal Revenue Service; New Jersey U.S. Senator Bill Bradley; Connecticut U.S. Representative Sam Gejdenson; Stacey Leyton, Vice President, United States Student Association; and Illinois U.S. Senator Paul Simon. Those individuals presenting prepared statements and other material include the following: Minnesota U.S. Senator Dave Durenberger; Pennsylvania U.S. Representative Joseph M. Gaydos; Jerry Davis, Vice President, Research and Policy Analysis, Pennsylvania Higher Education Assistance Agency; Connecticut U.S. Senator Joseph I. Lieberman; and Joseph A. Russo, Director of Financial Aid, University of Notre Dame (Indiana). In addition, prepared information was submitted by a professor, financial aid directors, an education consultant, and representatives from the American Association of Community and Junior Colleges and the Coalition of Higher Education Assistance Organizations. Included are the texts of Senate Bill 1845 entitled "Financial Aid for All Students Act of 1991" and House of Representatives bills 3050 and 2336. (GLR)

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HEARING ON H.R. 2336, THE INCOME-DEPENDANT EDUCATION ASSISTANCE ACT AND H.R. 3050, THE SELF-RELIANCE SCHOLARSHIP ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON POSTSECONDARY EDUCATION

OF THE

COMMITTEE ON EDUCATION AND LABOR
HOUSE OF REPRESENTATIVES

ONE HUNDRED SECOND CONGRESS

SECOND SESSION

HEARING HELD IN WASHINGTON, DC, FEBRUARY 6, 1992

Serial No. 102–90

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HEARING ON H.R. 2336, THE INCOME-DEPENDANT EDUCATION ASSISTANCE ACT AND H.R. 3050, THE SELF-RELIANCE SCHOLARSHIP ACT

THURSDAY, FEBRUARY 6, 1992

House of Representatives,
Subcommittee on Postsecondary Education,
Committee on Education and Labor,
Washington, DC.

The subcommittee met, pursuant to call, at 9:40 a.m., Room 2175, Rayburn House Office Building, Hon. William D. Ford [Chairman] presiding.

Members present: Representatives Ford, Miller, Sawyer, Payne, Unsoeld, Washington, Andrews, Reed, Roemer, Kildee, Klug, Goodling, Petri, Roukema, Gunderson, and Armey.

Staff present: Thomas R. Wolanin, staff director; Gloria Gray-Watson, administrative assistant; Maureen Long, legislative associate; Colleen McGinnis, legislative associate; Angelique Camfield, staff assistant; Rose DiNapoli, professinal staff member; and Jo-Marie St. Martin, education coordinator.

Chairman Ford. I am pleased to convene the subcommittee this morning for the first hearing of the second session of the 102d Congress.

Today we will hear testimony from a very distinguished group of witnesses on two pieces of legislation which were introduced by members of this subcommittee. We have before us this morning H.R. 2336, the Income-Dependant Education Assistance Act, introduced by Representative Tom Petri and H.R. 3050, the Self-Reliance Scholarship Act, introduced by Representative George Miller.

I am especially pleased that Senators Bill Bradley and Paul Simon can join us this morning, for both of them have introduced legislation similar to these two bills in the Senate. I am also very pleased to welcome our colleague Sam Gejdenson, who has been active in support of these proposals. I didn't think you did anything but write bothersome reform legislation, Sam.

[Laughter.]

Chairman Ford. On behalf of the subcommittee, I would also like to welcome Michael Bigelow, the Deputy Assistant Commissioner for Returns Processing, who will share with us the views of the Internal Revenue Service.

I hope that this hearing will enable us to fully explore these new initiatives for financing postsecondary education. I look forward to the testimony of our distinguished witnesses.

Let me just add a personal comment. For years businessmen and others have been coming up to me and saying, "Why don't you fools in Congress have a system for collecting student loans through the Internal Revenue Service?" Well, I want to tell you why. I've been advocating that since before Paul was Chairman of this committee over here and we have never had a Treasury Department willing to take on the job. It doesn't matter whether they've been Democrats or Republicans because I've tried both kinds. The Treasury Department apparently doesn't want to do anything it doesn't have to.

And the reason that we have not made a futile gesture toward this kind of provision in our reauthorization legislation is that under the rules of the House it would send the legislation off to the Ways and Means Committee where it may never be heard of again. And we would rather not get into a partnership with the Ways and Means Committee in writing higher education legislation.

So we intend, fully, to pass legislation here, send it over to the Ways and Means Committee because they have the right to the referral, and then they will have to wrestle with the Treasury Department about whether it should be done or not.

I think it's high time that the issue was publicly explored and the people have an opportunity to find out just who it is that doesn't agree that it's a good idea to use our tax collection system for collecting student loans and also doesn't think it's a good idea to have a repayment system that's income-sensitive. With that, I would like to call on Senator Bill Bradley first.

Mr. PETRI. Mr. Chairman?

Chairman FORD. Oh, pardon me. Mr. Petri?

Mr. PETRI. Thank you, Mr. Chairman. I really do want to thank you very sincerely for holding this hearing today, and to thank all of the witnesses for coming and testifying. At the outset, I would like to state that I've gotten involved in this area for one overriding reason, and that is to help devise the simplest, most efficient student loan program possible.

I didn't get into it to shift the balance between loans and other forms of student aid. I didn't get into it to shift the burden of paying for college away from parents and others and toward students. I did not get into it to promote one type of school over another. I did not get into it for any other broad ulterior motive.

I got into it because we can build a far better mouse trap. Our current loan programs are enormously complex, wasteful, unfair, and burdensome to students, schools, and to the taxpayers. If we were designing them from scratch today, it's hard to imagine we would come up with the Rube Goldberg contraption that we've got now.

With income dependence we can have a program open to everyone; far simpler for schools and the government to administer; far simpler for students at application, and more manageable and supremely flexible during repayment; attractive enough to draw business away from current programs even if we leave the current programs in place; and at the same time virtually eliminating the default problem and saving immense amounts of money.

Now, this last point is particularly important. Some people have attacked IDEA while completely ignoring the savings that it can create. But obviously those savings can be spent elsewhere. H.R. 2336 does not say anything about how the savings are to be used. But they could be used for increased grants, as Senators Simon and Durenberger have proposed. Or the Ways and Means Committee might want to use some of them to pay for deductibility of student loan interest. In any case, let's not ignore that feature of this "better mouse trap."

I'm especially pleased that we'll be hearing from the IRS today, because the central concept of IDEA and similar proposals is that education is partly an investment in human capital. As such, it can appropriately be financed through future income taxes.

Under IDEA, students agree to pay higher future income taxes in return for the wherewithal to earn higher future incomes. In fact, we shouldn't think of this as a loan program at all. It's a tax agreement which just happens to include an account for each participant with a formula that determines when additional taxes will end. Except for that, IDEA taxes are identical to the rest of one's income taxes.

Because of this, IRS collection is central to the concept. IDEA does not use the IRS simply as a matter of convenience because the IRS is regarded as a good collector. And IDEA will not provide a precedent for IRS collection of "nontax debts," such as child support or farm loans. IDEA obligations are related to income according to a bona fide tax schedule. Some people pay more and others pay less, depending on income over a period of years. And they agree in advance that these obligations will be income taxes. Therefore, the IRS is the appropriate agency to collect them, and I look forward very much to the IRS's comments on how a program of this kind can work.

I would also like to stress one other crucial point at the outset of the hearing. We will hear from a number of witnesses with both positive and negative comments, and I am sure committee members will have many questions. Through it all, I would ask all present to keep one thing in mind: IDEA, as contained in H.R. 2336, is voluntary. No one has to participate.

We take no current programs away except SLS, which is a worse deal than IDEA for anyone. Some will argue that IDEA is a bad deal for students compared to Stafford Loans. I think those analyses are faulty. But keep in mind that if IDEA really is a bad deal for some, they don't have to choose it.

With that, Mr. Chairman, I will resist the urge to comment forever and again thank you for having this hearing, and I look forward to hearing the witnesses.

Chairman FORD. Mr. Miller?

Mr. MILLER. Thank you, Mr. Chairman and thank you very much for holding these hearings, and I welcome our witnesses. This morning we have the opportunity to explore an idea that can provide dramatic relief to students and to families throughout this country.

Unfortunately, today when millions of American college students are lucky enough to graduate, they receive both the diploma and a crushing IOU from the Federal Government requiring that they pay their student loans, loans now that are much larger than I paid for my first house at their same age.

I think it's important to understand the cost of education, the escalation of that cost, and the impact on people seeking the educational opportunity. We find today that the entire system of financing a higher education is seriously out of step with reality. It's out of step with the new economics, with the new job market, and the ability of new graduating students to participate in that market.

Burdened with high debt from student loans, they find that they're entering a thinner job market, a more unstable job market, a job market that may require them to change not only jobs but, in fact, entire careers more than once during their working life.

Interestingly enough, we also now confront the new reality that the only people seeking educational opportunities are not those who are pursuing the pure college education but those who may have already benefitted from a college education but now find that the job that they hold has disappeared, has changed, or requires new requirements.

We see, in just the past few months, over 70,000 auto workers who will be laid off over the coming years from General Motors, people at Pan Am where the airline disappeared out from underneath them, the threatened layoffs at TWA, at Macy's Department Stores, at General Dynamics, at IBM, and McDonnell Douglas. Mr. Chairman and members of the committee, I hope that we would look at this as an opportunity for the first time to give Americans the possibility of investing in themselves.

Senator Bradley's bill, a bill that I am very proud to co-author, allows people to bank on themselves, to invest in themselves, to believe that they can improve their opportunity to participate longer and more productively in the American economy by having an account that will be available for them to use either to get their initial college education or training or to get re-training because of events that happened in their lives—very often that they have no control over because somebody ran their company into the ground or so saddled it with debt that it couldn't survive or technology changed or the education that they received 10 years ago is out of date with the needs of the marketplace today.

They will have the opportunity to call upon this account and go back to school to get trained to receive additional education, to improve their skills. And what we're saying to them is we're going to guarantee that you repay this loan because if you work, you will repay. But this time, you will be able to pay commensurate with your income, commensurate with the ability of your family to do so or yourself.

And we're going to guarantee to the taxpayers that you're not going to default, you're going to live with this debt and as you make more you will pay more. If you become unemployed, then you will not pay for that period of time. If you go back to work you will pay again.

For the first time, we have an opportunity to present to the American people an account that they can use for self-improvement, for self-investment, to improve the productivity of this Nation, our competitiveness, and the educational attainment.

I welcome you, Senator, and I'm very proud to co-sponsor this legislation with you. Thank you, Mr. Chairman.

[The prepared statement of Hon. George Miller follows:]

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STATEMENT OF

CONGRESSMAN GEORGE MILLER
(D-CA)

COMMITTEE ON EDUCATION AND LABOR

SUBCOMMITTEE ON POSTSECONDARY EDUCATION

FEBRUARY 6, 1992

Millions of American college students who are lucky to graduate this spring will receive both their diploma and a crushing IOU from federal government requiring that they repay their student loans.

These graduates will find themselves in an increasingly thin employment market, burdened with tens of thousands of dollars in student loan debts they cannot hope to repay within the ten years provided by the federal student aid program.

The federal government has provided billions of dollars annually in college loans and grants to assist these very students. Yet the defaults cost the taxpayers over $3.6 billion last year alone.

The entire system for financing higher education is seriously out of step with reality. Students simply cannot afford to repay mortgage-sized loans in today's economy. The costs are too high, the wages too meager. Nor does it make sense to require that a student repay the loan during a decade in which he is also trying to establish a career, buy a home, or start a family. That approach may have worked in the past, but it is ill-suited to the realities of the 1990's.

College students aren't the only ones confronting the education financing barrier. Over 70,000 automobile workers are losing their jobs at General Motors and thousands more at Macy's could be facing layoffs. Reductions in military procurement will leave many more without jobs or skills appropriate for a peacetime economy.

(MORE)

MILLER -- Page 2

These workers may need only to attend a short-term training program or a few classes at a community college in order to upgrade their skills for today's job market. Yet the cost of financing these training and education programs, especially for the unemployed, is prohibitive under the requirements of the traditional student loan program.

Senator Bill Bradley (D-NJ) and I have co-authored legislation to provide an additional means of financing education and re-training that is better for students, better for workers, and better for taxpayers.

The Self-Reliance Scholarship Act, H.R. 3050, allows students and workers facing retraining to repay loans used to finance their postsecondary education through their annual tax payments. It does not disturb the federal aid programs which are currently in place or impact the direct loan program in the Committee bill, H.R. 3553. I am delighted that Senator Bradley has joined us today to testify on our legislation.

Our income-contingent repayment proposal will save taxpayers millions of dollars in administrative costs that inflate the costs of other loan programs. Collection through the Internal Revenue Service will ensure a dramatic reduction in the multi-billion dollar default rate.

At a time when financing a higher education costs as much as buying a house, our repayment policies ought to be realistic and flexible. The Self-Reliance Scholarship Act provides the flexibility that will make a quality education accessible and affordable for all Americans, and far less costly to taxpayers, too.

# # #

Chairman **Ford**. Does anyone on this side have an opening statement?

Mrs. **Roukema**. Mr. Chairman, no, I do not have an opening statement. I choose to hear our very fine Senator from New Jersey. I think this is an important hearing. One the idea of which—pardon the pun—the idea of which I have certain strong reservations, certainly questions if not reservations, but I think it's an idea that is certainly worth probing. Anything that is going to expand higher education opportunity in this economy that is influx and with a Nation that is striving to compete in the global marketplace is certainly welcome. And I look forward to hearing the rationale and the exposition of the Senator from New Jersey. Welcome, Bill.

Chairman **Ford**. Anyone down here?

Mr. **Payne**. Ditto. Mr. Chairman, I would also like to echo what's been said by my colleagues here from New Jersey and we are very pleased to have our outstanding U.S. Senator Bill Bradley to come before us with this great idea. You know he is an idea person. He's a person who has for many years talked about the inequities in education, and he has talked about the opportunities for young people that are many times shut out because of economic standings.

Many times he talked about his upbringing in West Virginia and if it wasn't for the fact that he had an outstanding ability to play basketball he may have been one of those who would have been shut out from becoming a person of the stature which he is today.

And so I'm here to listen. I support the concept strongly. We have to open up education to make it a right rather than a privilege as it has become. So it's great to see you, Senator. Thank you.

Mr. **Roemer**. Mr. Chairman?

Chairman **Ford**. The gentleman from Indiana.

Mr. **Roemer**. Mr. Chairman, I too would just like to welcome Senator Bradley, Senator Simon, a fellow Midwesterner from the neighboring State of Illinois, and our colleague Mr. Gejdenson to the committee this morning to hear what I'm sure will be eloquent testimony on a very important issue.

As we've heard through field hearings and other hearings before the committee, Mr. Chairman, too many of our students are graduating with crippling debt rather than elevating degrees. We need to look at fundamental change, investing in our people and creating new opportunities. I look forward to listening to the creative approaches that will be put forth this morning.

Thank you, Mr. Chairman.

Chairman **Ford**. Thank you. Senator, you may have observed that New Jersey is not only well-represented but over-represented on this committee sometimes. So the New Jersey influence will be noted in the future on the legislative decisions in this committee. We have them on both sides and they tend to be the most effective members of the committee.

Go ahead, Bill.

STATEMENT OF THE HONORABLE BILL BRADLEY, A U.S. SENATOR FROM THE STATE OF NEW JERSEY

Mr. Bradley. Thank you very much, Mr. Chairman. And let me agree with the first part of your characterization in terms of being effective. I would ask unanimous consent if my full statement could be printed in the record, and I would like to take just a few minutes talking about the Self-Reliance Scholarship concept.

Chairman Ford. Without objection, your full statement will be placed in the record immediately following your comments today and you may proceed to comment in any way you feel most comfortable and any way you think will make the best record.

Mr. Bradley. Mr. Chairman, I needn't tell this committee about what's happened to the costs of higher education in the last decade and what's happened to Federal assistance for higher education in the last decade. The cost of higher education has risen over 50 percent. Federal assistance has risen about 20, 25 percent.

Public colleges and private colleges are dramatically increasing their cost tuition. Just in the last year public colleges have increased 12 percent. The average public college costs about $5,000. The average private college cost is around $12,000 and some go as high as $24,000.

I needn't tell the committee, because of its expertise and experience, how important higher education is to long-term productivity in this country. In fact, there are some new approaches to the theory of economic growth that assert the most dynamic and important element of improved growth prospects for our whole economy is in the education sector.

And if you want to pull productivity forward, there are two areas that you have to concentrate on in my opinion. One is in moving the bottom three or four rungs of the education ladder up several pegs. And the second is facilitating more people going to college and getting degrees so that they can contribute more fully to our economic progress.

It is with that in mind, combined with the fact that I think there is going on in the country today a slight pessimism that a major effort on higher education might correct—for example, in our State of New Jersey last February, a year ago, about 35 percent of the people said that their children would have a lower standard of living than they do. In July, 52 percent of the people in the State of New Jersey said their children would have a lower standard of living than they do.

I believe one of the central elements driving that pessimism is that college education is drifting out of the reach of a great number of New Jersians and Americans. And we have come to believe in this country that, if not a right, at least it was the main path to economic betterment. And when that is drifting out of the reach of people it is understandable that they would conclude that their children would have a lower standard of living than they do.

It is with that in mind that I worked through an idea that I call Self-Reliance Scholarships that Congressman Miller has introduced in the House. And, briefly stated, Self-Reliance Scholarships are programmed to allow any American up to the age of 50 to get up to $33,000 to go to college in exchange for an agreement to commit a percent of his or her future income for a specified number of years into an educational trust fund. That trust fund would then be available for other Americans to use to go to college.

It is a rather simple idea. If I could go back over the first statement, and Congressman Miller made this eloquently, it is available to nontraditional students. Student loan program, the Pell Grant program are primarily used by traditional students, 18-, 19-, 20-year-olds going to college.

Increasingly in America we have the phenomenon of the high school graduate who goes to work for 10 years in a job and discovers it's a dead end and needs more training but has no means really to be able to obtain that additional education. We have the phenomenon of the mother that raises children and at age 38 decides that she would like to go to college to have better prospects for the job market. We have the phenomenon of companies recognizing an international competition and they need to upgrade the skills of their workers and if they could, they would like to use the existing community college structure in their area but somehow or another they can't make the finances work.

For all three of these nontraditional segments of the potential college student population Self-Reliance Scholarships is a help. It is also obviously a help for the traditional student. We know that if you go to college you earn 60 to 70 percent more than if you don't go to college.

College is, in effect, an investment. So if we make an investment there should be returns on that investment. And that is the contract that someone who would sign up for a Self-Reliance Scholarship would agree to, that you would agree to obtain a percent, a certain amount of money, say for example $10,000 to go to college.

And in order to get $10,000, you would agree to commit 1.5 percent of your income for 15 years into an educational trust fund. Given that you earn 60 to 70 percent more, it's a pretty good investment. And the thought behind this was that we should have people, as many people as possible, going to the college that their ability will allow them to go to.

Now, a central point: this not a replacement for the Pell Grants or for Guaranteed Student Loans or for any other existing program. This is simply another good way to help families pay for college education.

Now, the cost of the program would be in a budget sense rather minimal because the only thing that you would really have to cover is the subsidy cost, the subsidy value. The default rate would be very low because I would envision doing what the Treasury Department, as the Chairman has stated, has been reluctant to do and that is having the percent of income taken directly off of your wages or directly off your income tax.

The IRS will argue they can't do this. I'm on the Finance Committee. I've heard this song sung many times. The fact of the matter is they are involved in child support enforcement and they are involved in a number of other areas, as Congresswoman Roukema knows very well. And they could also be involved in making sure that these commitments are kept, the percent of income off the wages.

I think that this idea is one that has struck a cord in the constituents that I've shared it with in New Jersey and in many audiences across this country. It is also the right time in my view. And I would hope that this year is the year that we be able to make this a reality, increasing the pool of resources available for all Americans to go to college.

Now, as I look at the members of this committee, there are many who have excellent ideas about higher education. I do not view this proposal in any way competitive with those ideas at all. I see this as another good way to try to help families send their children to college and Americans have the opportunity to go to college.

I appreciate the Chairman's offer for me to come testify. I, of course, will be totally dependant upon—not totally, but Congressman Miller will certainly be carrying this idea in part in the committee. And I look forward to working with the Chairman and committee members at any point that they might call upon me to do so. And I'm prepared to respond to any questions if you choose. I know that you have a long hearing list and I know there are a lot of witnesses. I'm prepared to answer questions. If you choose not to, that won't disappoint me either.

[The prepared statement of Hon. Bill Bradley follows:]

BILL BRADLEY
NEW JERSEY

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Senator Bill Bradley
Testimony on Self-Reliance Scholarships
House Committee on Education & Labor
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Good morning. Thank you, Mr. Chairman, for calling this hearing and giving members of Congress a chance to consider a major new idea about how to pay for college before the reauthorization of the Higher Education Act comes to the floor here and in the Senate. With your leadership, we have a chance to produce legislation that will make as big a difference in opportunity for those who want a better education as the original Higher Education Act of 1965. Let me also thank Congressman Miller, lead sponsor of the Self-Reliance Scholarship proposal here in the House, and Congressmen Petri and Gejdenson for their roles in promoting the idea of a new option for student finance. I agree with Professor Bluestone that this is an idea whose time has come.

To demonstrate the need for a program like Self-Reliance Scholarships, let me begin not with figures, but with a letter I received from a young woman in New Jersey: "When it was time for me to apply to college in the late 1970s," she writes,

> my choice of college was practically unlimited because of the comprehensive Federal financial aid programs.... Today my youngest sister, who is now 18 years old, finds herself in a very different situation. My sister has been forced to apply to colleges based on finances rather than her considerable academic ability. Her choices were severely curtailed by my parents' modest, middle-class income and the fact that she is the last remaining dependent child in their home. Even though my parents are "better off" than in the 1970s, my sister does not even have the same opportunity I had fourteen years ago.

This family's story is not unusual. It is happening all across America as tuitions skyrocket and financial aid shrinks. Last month the College Board reported that tuition at public universities jumped 12% in just the last year. Average tuition at a private college crossed the $10,000 mark for the first time, with some charging $22,000 a year or more. Families are finding that without a college education, their kids can't hope to get ahead, but that education is becoming unaffordable for middle-class families.

The tragedy is bigger than the individual family, however. It is a national tragedy of America shooting itself in the foot despite stiff international competition. It is a tragedy of America choosing to squander its human potential. It is a tragedy of America, by inaction, endangering our belief that the future can be better than the present.

For most of our history, higher education was the experience of very few Americans. World War II changed all that with the passage of the GI bill. With mature veterans filling the ranks, the number of college students nearly doubled. The result was the most talented workforce in the world and a new recognition of the value of higher education. State legislatures, alumni, and even the Federal Government began to invest in higher education. By 1970, enrollment doubled again to about nine million students. A recent study shows that low-income students gained increased their access to higher education by 41% between 1966 and 1977. Families, many without a college graduate in the house, came increasingly to see education's value and to recognize that, without it, life chances diminished.

But in the 1980s, college costs increased by 50 percent in real terms while Federal funds for student aid rose by only half that amount. And tightened eligibility took college loans away from 500,000 students in the last decade. That 41% access gain for low-income students in the decade ending in 1977 was wiped out by 1987.

The college cost trap hits the 85 percent of Americans who earn less than $50,000 after they are already bearing the strain of health care costs, energy costs, housing costs, interest rates, stagnant incomes and taxes. These pressures began to build and in some cases desperation set in. Last February, 35 percent of New Jersey parents believed their kids would have a lower standard of living than they have. In August, that number jumped to 51 percent.

These conditions led me to develop Self-Reliance Scholarships. When a family's income is not enough to meet everyday costs, that income should not also be a barrier to education. Instead, I believe we must find a way to harness the 60% higher earnings that a student will gain from higher education in order to pay for that education. What we need is something that builds on the virtues of independence and hard work to give everyone a chance to increase their life chances by going to college.

Self-Reliance Scholarships harness the value of a college education to get past the hurdle of paying for it. Students' own earning potential, not what their parents happen to earn, would open the door to whatever colleges they were able to get into. Students whose families earned too little to pay a State college tuition would not be turned away. Students whose families might earn a little too much to get aid under current programs would not be turned away. The 28-year old who has worked for a decade out of high school only to find that escaping a dead-end job requires new skills, and the mother who has raised children and now, at 36 or 40 yearns for the independence that a college education can bring, would all be eligible.

Self-Reliance Scholarships would give anyone, up to age 50, as much as $33,000 for higher education in exchange for a commitment to pay a percentage of the graduate's income into an education trust fund that would provide more Self-Reliance Scholarships for the next classes of students. The percentage of income each student would commit and the length of the commitment would be flexible, based on the student's choices and the amount obtained. If you took $10,000, for example, you could agree to pay back 1 ½ percent of your income for the next 25 years. Or, you could agree to pay a little more, say 2 ½ percent of income, and pay off the obligation faster, in just 15 years.

There would also be a ceiling and a floor on repayments. No graduate could avoid paying his or her fair share, and graduates fortunate enough to earn very high incomes at a young age would not be penalized for success. The student who took out $10,000 and agreed to pay back 1 ½ percent of income for 25 years would pay back, in the first year, no less than $477 and no more than $1,083. A graduate with income less than two-thirds of the average for college graduates would pay the minimum, and a graduate who made more than one-and-a-half times the average would pay the maximum.

This feature, in particular, distinguishes Self-Reliance from other proposals to link repayment to future income. The floors and ceilings that keep everyone's payment reasonable will make Self-Reliance appealing to the full range of students -- those who expect to do well early as well as those who want to be teachers or social workers and earn very little for quite a few years after graduation. If an income-contingent loan is an option in the current system, but only those who expect low initial incomes elect the option, this "adverse selection" will make it unworkable. The floors and ceilings on payment make Self-Reliance fairer, allow us to make it flexible and affordable, and make it likely to work where other experiments have failed.

I have developed Self-Reliance Scholarships because the current Federal student loan and grant programs do not adequately meet the needs of today's students. First, those sources of funds are shrinking in relative terms, while the cost of tuition is rising. The Bush Administration's latest answer is to let graduates deduct the interest they pay on student loans. How does that help a family that is declared ineligible for loans today? How does it help the graduate who starts at a low-paying job, who cannot meet her loan payments in the first place and who does not itemize her tax deductions? It does not help.

I should say here that this committee and your counterparts in the Senate have done a far better job than the Administration in striving to increase our investment in education and improve access for all students. But I believe we can and should do even more than increase eligibility or shift student loans from guaranteed to direct loans. It is time for some fresh thinking about how to pay for college.

I have been very gratified by the response the Self-Reliance idea has generated. College presidents are supportive; financial aid administrators think it's the right approach, but more important than all of that, when I talk about Self-Reliance with families in their homes and students at high school and college events they agree enthusiastically: This is an idea whose time has come. Tuitions are skyrocketing. Aid is shrinking. Self-Reliance is the answer.

For the United States to remain the Number One economic power in the world, we have to be ready for jobs that involve computers, information, numbers and intense creativity. We have to demand more from students, but we also have to promise more. We should promise that if you work hard, if you have ability, if you believe in yourself, and if you can get into college, you will be able to go. Self-Reliance Scholarships will help young people realize the promise by relying on themselves.

Chairman **Ford**. Thank you. During the Reagan Administration, when it was fashionable for the administration to attack Federal employees on every front, there was a system set up to find within the Federal Government all employees who had an unpaid balance on a student loan and then collect it through the IRS. Didn't we facilitate some sort of a program to collect through the IRS unpaid student loans for Federal employees?

Mr. **Bradley**. Well, defaulted student loans, yes. For Federal employees? I don't know if it was directed specifically to Federal employees.

Chairman **Ford**. Federal employees were the avenue that got us into it. Maybe that's why there was no objection to using the IRS as a collector. Later, we hitchhiked on that and added the IRS for defaulted loans as a way of meeting reconciliation targets. But by then, the die was cast, they were already doing it and they had to acknowledge that it could be done.

Mr. **Bradley**. Mr. Chairman, there is no question that it can be done. The IRS does have a pretty good computer. Some people would argue that it's not as good as it should be. Those of us who would like to collect more and are responsive to the IRS's request for more personnel in the Finance Committee and the Ways and Means Committee also would like that new personnel not only to collect taxes but also to help facilitate collection of certain things owed the government such as an agreement to pay a certain amount of your income in order to get a Self-Reliance Scholarship.

There's no question the IRS can do this. It's a threshold question, as usual. I mean, you know bureaucratic inertia institutions like to do today what they did yesterday, notwithstanding changing times and changing needs. And it is, of course, not within the jurisdiction of this committee to tell the IRS to do that. It is however, in the jurisdiction of the Ways and Means Committee and the Finance Committee to determine that they shall do that. I hope that's the way it will come out because, as you've said, there is no question that they have the ability to do that.

Chairman **Ford**. Thank you. Senator Bradley, recently a study was brought to my attention regarding what the difference is after 15 years between a student who comes out of school with a big debt and a student who comes out of school and goes into the same career path without the big debt. And there's a surprising difference.

What's surprising is not that there is a difference after 15 years in the assets owned by these two people, but it's the dimensions. This study found that after 15 years the student who started out after school without debt accounted for 5 to 10 times as much in assets accumulated during that first 15 years as a student who started out under the present system repaying their debt the way we do.

The impact at the low income end of the scale of this flat debt obligation is not, therefore, something that's temporary that you work out of as you make more money. It puts you behind the curve and holds you back making progress during the key early years of your career. And that's not a result we were trying to achieve. Obviously, it's something we would like to avoid.

All of the bills that are here suggest that we would avoid that unintended consequence to some degree by stretching out the repayment and making it income sensitive. That might be the answer to a problem that's being more and more identified by people that we're creating as a wake or a wave from our efforts as we go through the water.

Mr. **Bradley**. Mr. Chairman, I couldn't agree with you more. That's one of the aspects of the bill that we thought long and hard about. I think it would be the characteristic of virtually any income-contingent loan program, whether it's Senator Simon's idea or Mr. Petri's idea or others, that you would pay based upon your income therefore you would not have the phenomenon of getting out of college and having to pay a whopping part of your income in student loan repayments.

You would be able to have resources. You could count on a certain amount of your income that you would have to pay for repayment. You would have an idea as your income increased over time how much more but it would be a kind of set percentage of your income.

Now, in Self-Reliance, what we did, and Congressman Miller was instrumental or important in this, is we wanted to provide some certainty not only as to specific percent of income but also specific number of years. You can do one of two ways. You can either say, like we do, that you do both specific length of time and specific percent of income, or you can have a specific percent of income with an indefinite period.

We chose to try to be as definite as possible. And that, of course, led to a circumstance where there would be some people who made more than others paying a little bit more back into the fund. But there would be a cap of 150 percent of the average earnings for a college graduate and 66 percent floor for the average earnings of a college graduate.

But neither one of those changes would violate the principle that you asserted which is it's got to be better to pay a percent of your income because you will be able to afford that, particularly in the early years, and you wouldn't have the problem of the diminishment of asset accumulation.

Chairman **Ford**. Thank you. Mr. Miller?

Mr. **Miller**. Thank you, Mr. Chairman. And thank you, Bill, very much for your testimony and for coming up with this legislation and this idea. I don't have any questions because I think the most contentious point has been the historical one of IRS resistance to this. You have covered that very succinctly—it can be done.

I just think in terms of the realities, that it must be done because—you're so correct—otherwise we're simply foreclosing that opportunity for what eventually will be millions of young Americans and families to do that. In my own State we just went through a 40 percent increase in cost at the university and State college system. As I listen to my son's friends talk about that, that's extra semesters, that's extra time at home, it's time out of the job market, and above all, it's additional debt when they do enter the job market.

So thank you very, very much for your testimony.

Mr. **Bradley**. Thank you very much, George. If anyone doubts about the IRS you ought to ask them how they manage to compute for 110 million taxpayers three levels of tax bases for the alternative minimum tax, plus the regular tax, plus the gross cash tax. So it's just not an issue.

Chairman **Ford**. Mr. Petri?

Mr. **Petri**. I just have one quick question. First, I wanted to thank you for coming over here and for your important leadership in this area in advancing and giving credibility to this whole approach.

My question is this. In view of the large potential budget savings that could be obtained through either your proposal or IDEA, which both really go basically in the same direction, do you think this is something that the Finance Committee might be interested in adding to the coming tax bill? And to that end, do you think it's possible to come to an acceptable compromise with Senator Durenberger who sits on the committee with you, and with your colleague, Senator Simon, as this bill moves forward?

Mr. **Bradley**. I do have hope that a provision similar to this could be made a part of an overall budget. I know we have talked about it in the Finance Committee and I think that there are areas of compromise between what I've proposed and what Senator Durenberger and Simon have proposed in the Senate.

My concern is that this simply not be a replacement for existing higher education programs, and that's my major concern. And then I also think that the repayments schedule has to be clear enough so that it can be explained to people simply. And I think those are the two areas where there could be some fruitful discussions. And I would hope that we would be able to come up with some program. Things are moving. I think there is a chance.

Chairman **Ford**. Mr. Sawyer?

Mr. **Sawyer**. Thank you, Mr. Chairman. I don't have a question, just a brief observation Senator. And that is that the demographics of college populations has changed so markedly over the last 25 years that measuring eligibilities based on parents' capacity to support children really doesn't reflect the needs of that marketplace anymore. It is the capacity of an individual who may, himself, be a parent to invest in his own potential earning capacity that is, perhaps, the most compelling part of this whole thing. It puts control into the hands of the person who is taking advantage of the loan.

Thank you very much for introducing this. I look forward to working with George and our chairman in helping to make this law.

Mr. **Bradley**. Thank you, Congressman. That is the reason it's called Self-Reliance. Pell Grant, Student Loan Program depend on parental income. This depends on the individual and the individual taking on the commitment that in exchange for the money they agree to a percent of their income for a specified number of years.

Chairman **Ford**. Brace yourself, Senator Bradley. Marge?

Mrs. **Roukema**. We've been good friends for a long time haven't we? We don't always agree but we've been good friends.

Chairman **Ford**. But I can't pass up an opportunity to tease you; you'll understand that.

Mrs. **Roukema**. The Chairman thinks I'm pushy, I think.

Senator, I don't expect you to answer the specifics of my questions here. I'm just setting up a framework for discussion. And frankly, I think that conceptually there could be agreement between us, particularly with my husband having had experience when he went on to medical school of a similar program although it was a private scholarship program. It was a question of borrowing the money—in that case it was at no interest—but making arrangements with the scholarship fund to get your payment for medical school tuition and then have an agreement as to what you paid back to the fund. And it became a revolving fund for future medical scholarships. In our city of Paterson it was the McBride Scholarship Fund.

Conceptually, this is the same idea. But here we're talking about a much larger program and we're talking about taxpayer money, I think, being involved here. So my concerns are—and again, I would probably submit these questions to you at a later time—revolves around the question of actuarial soundness of this program. I'm not sure about the full repayment schedule that you have here, but could you answer this question: Do I understand that there is a subsidy here or is it full payment for value?

Mr. **Bradley**. You have to cover the subsidy value of the loan in the budget, that is what you have to raise. You don't have to raise money in a direct loan program because it's simply a transfer of one kind of asset to another. And what this is, is it's about $700 to $800 million a year, basically. It's much less because the defaults are down. The banks are not a part of it.

And I would finance that amount by putting a 10 percent surtax on people who make more than $1 million. And that would cover the budget cost for this program. Now, because we are——

Mrs. **Roukema**. Excuse me, Senator. On an annual basis that would be ongoing and that offset on taxes would set the actuarial soundness of the program?

Mr. **Bradley**. It would set the budget soundness and you wouldn't be increasing the budget deficit. Now, actually, based upon some numbers that I'm aware of that are going to come forward in the next couple of days, you could probably do that for less than 10 percent on people who make more than $1 million because it turns out that our estimators have discovered that there are a lot more people who are making income over $1 million and not as many making capital gains over $1 million. So you could probably do it for a little less than 10 percent, probably 7, 8 percent.

Mrs. **Roukema**. Well, that's very helpful. I'm glad that you noted that, the budget neutrality of it. But the actuarial soundness, that's what I want to go into at another time. I don't really have all my questions fully formulated but we've had enough experience, as you know, with problems in government guaranteed programs, whether it be PPGC that my subcommittee is dealing with, or banks or even home mortgages, FHS mortgages. And so we must be very careful in setting up such a program for the liability there, yes.

Mr. **Bradley**. I'll take a run at it if you want me to, not that I'll have all the numbers right, but——

Mrs. **Roukema**. No, I understand.

Mr. **Bradley**. The actuarial soundness of the program of the Self-Reliance Scholarships depends upon the estimate of average earnings for a college graduate over a 20-year period being correct. If, for example, the average earning is higher than you have projected, then you are in a basic surplus. If, on the other hand, it's lower than you have projected, then you have shortfall.

But one might point out there are other programs that are also premised on particular income growth in the overall economy, one of which is Social Security. If you had a dramatic drop in income, you would have a problem with Social Security as well. So this is not an unfamiliar concept in terms of projecting but it is not the same as if you simply took the loan and committed to a percent for as long as it takes to repay the loan, plus whatever prime was.

And that doesn't give you certainty as to the number of years you would have to be paying a percent of your income but it would eliminate the uncertainty as to whether you have projected correctly on average earnings for a college graduate.

Mrs. **Roukema**. Thank you, in a sense you anticipated one of my other questions. But we will have to explore this a little further whether there are other revolving funds and what our experience has been. You alluded to Social Security. I just, offhand, can't think of other revolving funds like this, unemployment compensation perhaps? Well, not a——

Mr. **Bradley**. I don't know if you would call the highway trust fund a revolving fund, but that clearly is——

Mrs. **Roukema**. Well, we can look into it.

Mr. **Bradley**. Yes.

Mrs. **Roukema**. All right, thank you very much, Senator.

Chairman **Ford**. Mr. Payne?

Mr. **Payne**. Yes, thank you. Senator, I guess the basic principles—I'm trying to see what they are—the proposal would provide anyone up to age 50 with up to $33,000 and a repayment would be a fixed percentage of income up to 5 percent, over a period of 25 years. What would happen if a 50-year-old who you would expect, if it's a female, maybe to work to 62? And if indeed you come up with $33,000 at 5 percent, you're going to run into Social Security. I didn't want to throw in any complications—I'm not a tax person and I did read your simplified tax plan of 86, but——

Mr. **Bradley**. Well, you mean if someone signed up at age 50 for 5 percent for 25 years, would they still be around at 74 to make their payment? Well, I think that's a legitimate question. We felt that that's as high as we could get it in order to get the amount of money back into the fund that we needed. I tried to go as mature as possible so that it would be available to more people.

Now, if someone could come in and demonstrate that that jeopardizes the stability of the fund, then you've got to move it to 48, well, we'll move it to 48. That number is guided by the exact question that you raised, which is if somebody makes a commitment will they actually be able to put the money back in? And if they don't put the money back in then will the fund itself have shortfall.

I'm sensitive to that and that is something that I would be prepared to address or change depending upon the data. Again, the average public college is about $5,000 and I think that you won't find a lot of people taking $33,000 at age 50; that would be my guess.

Mr. **Payne**. Right, thank you. I agree. I'm one of those that still believe that everything doesn't necessarily have to be budget neutral. Especially if we're talking about an investment in America and we're talking about trying to get back our competitive edge which we seem to have lost over these past 10 years as you've indicated. The wealthy have become much more wealthy, that's probably why you were surprised with the larger number of millionaires. But the poor have increased and the so-called middle class also have had serious problems.

So if we're going to reinvest in America I think that this is as important as that $2 billion B-2 that they're going to build in 1993 at that cost. So I agree with you and it wasn't to say that I'm in opposition but, I'm even of the opinion that education does not necessarily have to be budget neutral because of what it does to enhance our competitive edge in the future.

Thank you, Mr. Chairman.

Mr. **Bradley**. Well, let me respond. I agree with that. We do finances for the millionaire surtax but keep in mind this is a universal program. Anybody in America up to the age of 50, which means even a millionaire's son might want to be self-reliant. In which case you don't depend on the trust funds, you sign the contract, get your money, repay over 20 years. So the idea is this should be available to everyone.

Mr. **Payne**. Thank you. Senator Rockefeller used to talk about whether he wanted to inherit it or do it the old-fashioned way.

Chairman **Ford**. Mr. Andrews?

Mr. **Andrews**. Thank you. Senator, thank you for being with us this morning and for lending your credibility to a belief that I think you share with most of us on this committee, which is that although there are a lot of outstanding programs of access for higher education financial aid, there is something fundamentally wrong with our system right now. There are too many people who have the ambition and the ability to get a higher education who aren't getting one, and we have to do something that's really different than what we've been doing before, and not just rearrange the furniture a little bit.

I appreciate the fact that this program, I think, goes a long way toward filling a void for the nontraditional student, as you said and as Congressman Sawyer said. We know in our State so many people who are not the 18-year-old leaving home for the first time with mom and dad at home, but they're people who have been in the work force for a while, the single parent, et cetera.

So I think that you're absolutely on the right track. I look forward to working with you to try to persuade the Treasury Department to take a more active role in doing what we all know it can do. And I just have one specific question, which is: Does the program contemplate students making loan repayments while they're in school? And if not, what would be the source of those repayments and what would it cost, generally?

Mr. **Bradley**. You can do it either way, it just changes the table. It changes the repayment table. In my view, either way is fine. If you sign up to begin during your years in college then you basically will have a longer repayment. If you sign up to do it after college, then you probably would have slightly shorter repayment.

Again, the concept is not repayment of loan but it is return on investment. The government would be making an investment giving you the $20,000 or the $10,000 and you would be providing the return on that investment to those who made the investment in you, the government, by a percent of your income. You could leave it to the recipient's option as to whether they would choose to begin in college or immediately after.

Mr. **Andrews**. Would the minimum payment apply to someone who is in college? Your testimony indicates that——

Mr. **Bradley**. The 66 percent, it could. I think if you're going to—this deals with the cross subsidy issue—if you were going to have the cross-subsidy and not have adverse selection, which means people who are going to make a lot of money not participate in the program because they've got to pay more, then you would have to apply both the cap and the floor to anyone at any point in participation in the program in order to keep it solid.

Mr. **Andrews**. Thank you very much.

Mr. **Bradley**. Thank you. And let me thank you also for your interest and leadership in this.

Mr. **Sawyer**. [presiding] Mrs. Unsoeld?

Mrs. **Unsoeld**. Just one minor concern because I think there are a lot of good ideas in this, but by humanizing an inhuman loan system that students are currently faced with do we run the risk of getting ourselves off the hot seat for providing more grants for students who are also self-reliant but may have less resources to start with. I don't want us to be thinking that loans are the way that we no longer have to pay adequate attention to giving grants to.

Mr. **Bradley**. No, this, as I said, is not a replacement for existing programs. In fact, I think there can be a major argument that we ought to increase, say, Pell Grants. But it is another good way to pay.

The maximum you can get is $33,000, so what will inevitably happen is you'll find a student who, if they are eligible, would get a Pell Grant. And if they're eligible, they will get a guaranteed student loan and then they'll be—this is a traditional student—then they'll be $3,000 to $4,000 short of being able to go to the college that they could get into but couldn't afford.

And so, enter Self-Reliance Scholarships, they will plug that financing gap with Self-Reliance Scholarships that will allow them to go to the college that their ability allowed them to get in to. And they won't have to settle for what was second or third choice simply because of their family income and the amount of resources available to them through Pell Grants and Guaranteed Student Loans.

Mrs. **Unsoeld**. Just as long as it doesn't take the political heat off of us to provide those grants. I appreciate your work——

Mr. **Bradley**. Well, again, I would—if you would just take a look at some of the new work done on economic growth, it breaks up what various things contribute to economic growth, labor, capital, and other things, you find that technology which was your traditional triumvirate, your third part of your triumvirate in the traditional theory breaks up now into quality investment in education and ideas being key engines for economic growth.

Mrs. **Unsoeld**. You don't have to convince me.

Mr. **Bradley**. All right, well I'll save that speech then.

[Laughter.]

Mr. **Sawyer**. Mr. Reed?

Mr. **Reed**. Thank you, Mr. Chairman. Senator Bradley, I want to commend you on your leadership on this important issue. I have a specific question about the financing mechanism. Essentially what you're saying is that the only budget costs would be the interest that the Federal Government would pay on the debt it borrows, and that's about $700 million?

Mr. **Bradley**. Well, the subsidy cost. The subsidy cost, as you know, in current loan programs deal with banks and deal with default rates. But no banks here, it's a direct loan so that's out of the picture. Will there be any defaults? Well, you know, some people could die but not a whole lot. There would be minimal, minimal costs, certain administrative costs.

Mr. **Reed**. So, the subsidy cost of administration, default—which is projected to be low, and the interest cost of borrowing the money from the government?

Mr. **Bradley**. That's it, yes.

Mr. **Reed**. And you're going to finance that. Then, when these people pay the money back into the system, do you anticipate at any time that those payments back to the system would make this fund self-sustaining?

Mr. **Bradley**. Yes, I do. It's estimated at about 16 to 17 years down the road you end up with a self-financing trust fund. So that from the standpoint of the investment in higher education, you have something that is forever. So this is a little bit like an investment in, say, a bridge or a road that once it is built finally—maybe looking around New Jersey, it's like 287, a road that never seem to be completed—once it is built, it's forever. And that is another aspect to this that I think is enormously attractive because it makes the long-term investment question very clear.

Mr. **Reed**. One other quick question—less a question than sort of a thought—if this is run through the tax system, presumably they would have priority in any collections. Have you or your staff thought about any adverse effect on other forms of lending?

I guess the other way to look at it is, have you thought consciously about how you would accommodate this program with the Stafford Loan and the other loan programs?

Mr. **Bradley**. Well, this would be separate. It would be a third or fourth good way to pay for college education. How the programs would interact I think is very difficult for anybody to say now. My guess is that they would be layers and this would be the final layer that would try to plug a hole.

Mr. **Reed**. I guess one point, not to deflect the importance and the significance and substance of the program, is that there could be a situation where the Department of Education and the Treasury are fighting over the assets of an individual——

Mr. **Bradley**. Oh, you mean you would have the Department of Education trying to get the Guaranteed Student Loan and the IRS trying to get the Self-Reliance Scholarship?

Mr. **Reed**. Yes.

Mr. **Bradley**. Well, in that case, there's no question in my mind, the IRS wins.

[Laughter.]

Mr. **Reed**. So have you talked to Mr. Alexander about this program?

Mr. **Bradley**. Well, I'm certainly willing to talk to anybody about this program because I think it's terribly important.

Mr. **Reed**. Thank you very much.

Mr. **Sawyer**. Mr. Kildee?

Mr. **Kildee**. No questions.

Mr. **Sawyer**. Thank you very much, Senator.

Mr. **Bradley**. Thank you, and let me apologize to Senator Simon who, if he's still there, I know how busy these people's time is and I thank you for allowing me the time. I apologize for taking Senator Simon's time, but as for Congressman Gejdenson, well——

[Laughter.]

Mr. **Sawyer**. Thank you, Senator Bradley.

Senator Simon, it's a pleasure to have you back here before this committee.

STATEMENT OF THE HONORABLE PAUL SIMON, A U.S. SENATOR FROM THE STATE OF ILLINOIS

Mr. **Simon**. Thank you, Mr. Chairman. I feel at home in this room. I spent a lot of years in this room. It is a pleasure to be here. And I would ask unanimous consent to insert my statement in the record and also the statement of Senator Durenberger who is a cosponsor of my legislation.

Mr. **Sawyer**. Without objection.

Mr. **Simon**. Mr. Chairman, I want to commend you and Bill Ford and Tom Petri and everyone else who has said, "Let's take another look at this thing." About a year or year and a half ago I said to my staff, "Instead of just tinkering at the edges on the higher education bill as we have done the last two times we reauthorized, let's see what we can do to really do something significant for the country."

And as it turned out, my colleague Dave Durenberger was thinking along the same lines and we ended up with the Simon/Durenberger bill. And let me add I'm a cosponsor of Bill Bradley's bill. We're going in the same direction. I think there are some political problems in terms of getting the Bradley bill enacted that we have fewer problems in our bill.

First, what you have done here in raising Pell Grants is extremely important. If you take the old G.I. Bill after World War II and if you were to put an index on it, that would be today $8,100 in assistance and there was no income qualification on the G.I. Bill. The Pell Grant today is $2,400 and you have to very, very lucky if you're eligible for the Pell Grant.

What we do in our bill is we take the subsidy that we now give to the bankers, to the lending institutions—and I would remind you and we're running into some opposition obviously from the lending institutions, but I would simply remind you this is a higher education assistance bill. It's not a banker's assistance bill. It is not a Sallie Mae assistance bill. This is to help students and colleges and that's what we ought to be doing. And we think our bill moves in that direction.

With the present loan programs, in a recession, what do people do? There is nothing income-contingent. We are imposing all kinds of difficulties on people who have been students under the present program. We ought to move away from that. And what our proposal is, like the Bradley proposal, is income-contingent, basically exempting the poverty level, and we make it self-financing.

Borrowers pay back the principal plus interest. And we use for interest treasury rate plus 2 percent. And the 2 percent more than takes care of defaults. I heard Mrs. Roukema talk about, "We're talking about taxpayers' money." You bet we're talking about taxpayers' money. We're talking about taxpayers' money when we talk about $3.4 billion that we're going to spend on student loan defaults this year alone.

This program gets rid of the student loan default problem. It much of the paperwork. That's why the GAO says a direct loan program simplifies the paperwork for colleges, for students. Anyone who wants to is eligible for the loan. We say you can get up to $6,500 the first 2 years, $8,000 the next 2 years, and $11,000 to $30,000 for graduate school depending on the cost of the program. Obviously, if you get a Ph.D. in English Literature, it doesn't cost as much as if you're going to be a physician or something like that.

IRS collection—I couldn't agree more with Bill Ford and what he had to say before about IRS collection. The answer is yes. You're going to hear from the IRS. They don't want to do this. No agency wants another function tossed at them. But we have to ask what is in the national interest. And it is clearly in the national interest that we develop our human resources.

Economists don't agree on very much, as all of us know. They do agree on one thing, and that is the United States is going to compete with the rest of the world either through lower wages or higher skills. And this proposal says, "Let's invest in higher skills so that we can lift what we do in our country."

It also moves away from the present program which discourages people from making the choice they really want to in terms of career. Let's say you're a student in Washington and you're trying to decide to become social worker or do you become a lawyer. Frankly—I don't mean any disrespect. I married a lawyer. My daughter is a lawyer—we probably need more social workers than more lawyers in our society today. But our present systems skews it in the wrong direction.

We use the money that we save to shift over the subsidy. We make the loan program self-financing. You begin to pay after you get out of school and you pay either until the loan is paid or 25 years, and at the end of that it is cut off. But the 2 percent over treasury rate more than compensates for any defaults.

And then we take the money that we now subsidized the lending institutions and apply it to Pell Grants. And frankly, what we have done in order to comply with the Budget Summit Agreement, we have added $600 to Pell Grants and we have made that an entitlement. If we can work out, in conference with the House, some system where we can make entitlement of Pell Grants, period, I'm all for it. I have to tell you candidly, in the Senate to pass something we can't do more than whatever we provide the revenue for. I think that's the political reality.

Now, we're going to provide an option for schools. We're going to say, "You can go whichever way you want. You can go our program. You can go the current program. And you get your choice." And to Sallie Mae and the banks who are now telling schools, "Oh you're going to have all kinds of paperwork," the GAO doesn't say that. But if any school wants to not use our program they don't need to. We give them the option.

But we ought to do better for this country than we've been doing and we can do it. I talked to Bill Bradley. We've had some conversations about working out a compromise. Real candidly, one of the concerns I have in the Bradley proposal in terms of getting it passed in the Senate is the additional tax that is there. Frankly, I will vote for it tomorrow, but I don't know that we can pass that in the United States Senate. I don't know that we can get the President to agree to it.

Finally, let me just add you're going to hear from, as I understand this morning, also from the Pennsylvania Higher Education Assistance Agency. Lending agencies that come here and that agency and the others do good work and they have done good work, just as Sallie Mae has done good work. But sometimes agencies get interested in perpetuating themselves rather than the service they were originally designed to do. And when anyone makes any money out of the present system, take it with a grain of salt. It's like the tobacco institute people who come in and tell you, "We have research that shows cigarettes don't do any harm."

The question we have to ask ourselves is: How can we more effectively help students? I think this idea is moving in the right direction. And Tom Petri, we have to give you a great deal of credit for helping to pioneer in this.

I would be happy to answer any questions.

[The prepared statements of Hon. Paul Simon and Hon. Dave Durenberger follow:]

Statement of

Senator Paul Simon

before the

Postsecondary Education Subcommittee
of the
Committee on Education and Labor,
U.S. House of Representatives

on the concept of
income-contingent student loans

February 6, 1992

Mr. Chairman and members of the subcommittee, thank you for the opportunity to testify on the concept of income-contingent loans.

I must begin by emphasizing that providing income-contingent loans is not the most important thing we can do to promote equal opportunity in this Nation. The best way to help more of our troubled youth find skills and jobs, the way to improve our productivity in the long term, is to invest in our human resources by making more *grants* available to students from low- and middle-income families. I commend the members of this subcommittee and the full committee, and particularly the Chairman, for their insistence on a Pell Grant entitlement in this reauthorization of the Higher Education Act.

Anyone who doesn't believe that more scholarships can help the economy should look at the old G.I. Bill. It was conceived of as a gift to veterans of World War II, nothing more. But it turned out to be a tremendous investment in our own prosperity. If you were to take that old G.I. Bill and add inflation, it would be worth today more than $8,100. That helps to put the proposal for a $6,500 Pell Grant in perspective.

Mr. Chairman, the student loan proposals we are discussing today offer clear, dramatic improvements in student assistance. This hearing is taking place in the midst of a national recession that, among many other things, is severely testing our present student aid structure and all of its flaws in ways that make these differences that much clearer and more dramatic. Right now, across this nation, thousands of young adults, assaulted by the effects of the recession, are confronting the choice of making the monthly payment to the bank on a student loan, or going into default to use that money to pay the mortgage and keep the family home. And who will pick up the tab if the choice is to default? The taxpayers will.

There is a better way, a plan that would prevent this dilemma, prevent these damaged credit records, prevent these defaults, prevent the cost to the taxpayer, and give borrowers a reprieve when they need it. Income-contingent loan repayment is that better way.

Because even if we can significantly expand grant aid -- which I hope we do -- there will still be a huge demand for loans, and some students will still be saddled with large debt burdens, particularly at the graduate school level. That is why we must do everything possible to ensure that money in the student loan system is not wasted on middle players and bureaucracy, and we must do what we can to minimize the negative consequences of student debt burden.

The fact that there are a number of different proposals in Congress for income-contingent loans is evidence of the great appeal that the concept has. While there are differences in the approaches that the bills take, S.1845 (the Simon-Durenberger bill) and the separate proposals by Senators Durenberger, Bradley, and Akaka, and Representatives Petri, Gejdenson, and

Miller, all have three elements in common:

--**Universal eligibility.** The loans are available to any student, regardless of their family income. This significantly reduces the paperwork that is now required to figure out if someone qualifies for a loan program based on their family income and other factors.

--**Direct lending**. The funds flow directly to students from the Federal government, through the schools, at interest rates that are wholesale, not retail. As you know, this simpler process was made more feasible by the reforms in the FY91 budget bill.

--**Income contingency**. The payback depends on the student's income after graduation, and operates through the income tax system--a far more efficient and effective system than the current collection efforts.

Income Contingency, IRS Collection

It is this third common element that I know the subcommittee is interested in today. Student loan debt creates a number of problems. First, many youth and adults decide against going to college, because they are afraid they might fail, and they won't be able to pay off their loans. With an income-related program, that fear is reduced. During a period of unemployment or low wages, the required payments are reduced automatically.

Second, too many students don't do what they want to do with their lives, because of the loan payments they need to make. This might be a scientist who wants to be a high school teacher, but works for industry instead. Or a doctor who enters a high-paying specialty instead of working in an inner-city health clinic. Debt burdens skew these career decisions.

Finally, large debt burdens postpone dreams. I know a couple in Southern Illinois who are paying more than $800 a month in student loan payments. They would like to buy a home, but they simply can't afford to. Income-contingent payments would help to make their debt more manageable.

Income-contingent payments and IRS collection also help us to address the default problem. A large part of the current problem is that people go through a low income period, default, and then never pick up where they left off. By reducing the required payment based on income, borrowers can go in and out of the system without trying to figure out who owns their loans. Also, for those people who do have money, having the IRS as the collection agency will make it much more difficult for them to avoid paying.

The Financial Aid for All Students Act, S. 1845

The proposal I introduced with Senator Durenberger does a number of things, and it is designed to comply with the budget agreement reached last year. First, it replaces the current Stafford and SLS programs with a new loan program called IDEA Credit. This is similar to the program developed by Representatives Petri and Gejdenson; I will describe the differences later in my testimony. Replacing those programs with a new program that does not require a government subsidy allows us to save most of the current costs of the guaranteed student loan programs, currently about $2.7 billion for fiscal year 1992.

We use those entitlement savings to increase the Pell Grant by $600 above whatever level is funded by the appropriations committees. If we did that this year, 470,000 additional students would receive Pell Grants. Then we establish a new Excellence Scholarship program, capped at a total of $500 million, to provide $1000 scholarships to students who do take a challenging curriculum in high school, do well in college, and/or participate in early intervention and student support services programs. Finally, we provide funding for a block grant of $100 million to the states for expanded early intervention programs, like the "I Have a Dream" program pioneered by Eugene Lang in Harlem. This part of our bill is based on a proposal developed by Sen. Jeffords.

Because IDEA Credit can offer lower interest rates than the current system, no origination or insurance fees, and more grants, most students end up with less indebtedness after college under S. 1845, and all have more reasonable and flexible loan payments based on their income.

Our bill is not written in stone, and some have suggested that the savings be used for other purposes, such as continuing some type of in-school interest subsidy. Others have suggested that the program be made available at the option of the school. I have discussed these suggestions with Sen. Durenberger, and they will likely be incorporated into the amendment that we will offer on the Senate floor when the Higher Education Reauthorization bill is considered.

Income-Dependent Education Assistance (IDEA) Credit

The income-contingent loan system in S. 1845 is based on the Petri proposal: payments are adjusted on a progressive scale based on income, the repayment period varies, and amounts owed after 25 years are forgiven. I will not go into the details of the repayment or collection process, because you have the experts here today. But let me list the differences between IDEA (Petri-Gejdenson) and IDEA Credit (Simon-Durenberger):

--IDEA Credit replaces, instead of supplements, the current Stafford program. (Both proposals would replace SLS). This results in a savings of more than $2 billion a year.

--IDEA Credit begins with the 1994-95 academic year, instead of upon enactment.

--IDEA Credit is the responsibility of the Department of Education, not the Department of the Treasury. The income tax collection mechanism is established through an agreement between the Secretary of Education and the Secretary of the Treasury.

--To ensure that parents are dependent students' first source for aid, those parents must first be notified of their eligibility to borrow under the PLUS program, before the students can receive IDEA Credit.

--IDEA Credit is more sensitive to family size: Instead of just protecting an amount equal to the tax filing threshold, the protected amount is equal to the standard deduction and any exemptions applicable to the borrower (i.e. the maximum payment is 20% of income above the standard deduction and exemptions).

--IDEA Credit has no penalty for higher income participants or for early repayment. Borrowers are explicitly allowed to pay more than the amount due, if they choose to (for example, if they want to avoid negative amortization).

--To reduce any incentive for schools to increase tuition, IDEA Credit limits the loan to the cost-of-attendance in 1991-92 (reviewed after two years).

--IDEA Credit includes *no* automatic indexing. After 18 months, the Secretary reports to Congress on the effects of the program on tuition, and the effects of inflation on the loan limits and the progressivity factors used for the repayment amounts. If Congress does not take action, the Secretary may adjust the amounts in consultation with the appropriate congressional committees.

--In IDEA Credit, the Secretary is given some discretion to determine, by regulation, what to include or exclude from the definition of income.

--IDEA Credit requires the Education Department to use a similar method in providing funds to schools and students as it does in the Pell Grant program.

--Instead of setting different higher loan limits for specific medical specialties, IDEA Credit provides the Secretary some discretion in determining which medical and doctoral students should be allowed a higher limit. Also, there is no extended repayment option for medical interns.

The PHEAA Memo

Mr. Chairman, later this morning you will hear from a representative of the Pennsylvania Higher Education Assistance Agency (PHEAA). I am tempted to simply say what I have said about some of the reports on direct lending that Sallie Mae has put out: A report on student loans by a guaranty agency is like a report on smoking by a tobacco company. You have to consider the source.

But I would like to address some of the issues that PHEAA raised in a November 5, 1991, memo that was provided to my office a few weeks ago. (I should note that PHEAA has never expressed its concerns, or double-checked its assumptions, with my office). Essentially, PHEAA argues that low income students would have to pay more under IDEA Credit than under the current system. This conclusion is based on two assumptions, both of which are in error:

--The PHEAA memo looks only at the loan program, instead of the package that Senator Durenberger and I are offering. I would not propose to eliminate the in-school interest subsidy if it was not balanced by a Pell Grant increase. (Moreover, the amendment we will offer in the Senate may maintain the in-school interest subsidy, making PHEAA's claim even less meaningful).

--The PHEAA memo assumes that our program *requires* students to spread their payments out in order to make them more affordable. In fact, as I noted above, the required payment amount is a *minimum* due based on the borrower's income. Our bill explicitly allows students to pay more if they can afford to. This provides students with flexibility.

Once you consider these errors, the whole PHEAA argument becomes irrelevant. For the record, I have included with my testimony a more detailed discussion of the PHEAA memo, prepared by my staff.

Conclusion

I commend you, Mr. Chairman, for your willingness to consider, and even promote, innovative approaches to helping American families pursue their dreams of a higher education. I have experienced, over the past few months, what I imagine you have been dealing with for a year: the onslaught from lenders, guaranty agencies, Sallie Mae and others with a financial interest in the current system. I don't have anything against Sallie Mae or lenders, but we have to decide if the purpose of the student aid programs is to subsidize banks, or to provide aid to students. And I don't have a difficult time making up my mind on that.

It is clearer today than it has ever been that we need a strategy to regain the high-wage economy our nation once took for granted. And in any equation, education and job training must be the key elements of that strategy. The plan you are considering today would expand educational opportunity and invest more in our people. Opening postsecondary education to all who seek it is, in the end, not so much a gift to them as it is a gift to ourselves.

Again, I thank you for the opportunity to testify.

MEMORANDUM

To: Selena Dong, United States Student Association
From: Bob Shireman, Office of Sen. Paul Simon
Date: January 30, 1992
Re: **PHEAA's analysis of IDEA Credit**

As I promised last month, here are my thoughts on the November 5, 1991, memo from Pennsylvania's guaranty agency, the Pennsylvania Higher Education Assistance Agency (PHEAA), analyzing the Simon-Durenberger IDEA Credit proposal.

Essentially, PHEAA makes a number of erroneous (and some outrageous) assumptions designed to make IDEA look like a bad deal. This is not surprising given the agency's vested interest in the current programs. When the errors are corrected, IDEA is clearly the better option. This is because through direct lending we can buy more student aid with the same government subsidy; and with IRS collection we can have a program that is sensitive to income, automatically giving more flexibility to borrowers with large debt burdens.

I should emphasize that it clearly would be better to provide students with more grant assistance. But given that some students will have to borrow, there should be no question that it is better to have lower fees, lower interest rates, and increased sensitivity and payment flexibility based on the borrower's future income.

I. OVERVIEW

This memo is divided into two main sections. The first section looks at "the front end"-- the amount of aid that is delivered to students in the current system versus S. 1845, the form that it takes (grants, loans, payments of interest), and the resulting indebtedness. The second section looks at "the back end"-- the repayment of loans under each proposal. That is followed by a brief discussion of the concept of "discounting."

At the front end, PHEAA makes a number of errors and inappropriate assumptions in its analysis, resulting in a negative portrayal of the Simon-Durenberger proposal. For example, PHEAA ignores the increased grant aid that is provided under the Simon-Durenberger plan. I offer a new analysis that addresses PHEAA's criticisms, but (appropriately) assumes that the total government subsidy is the same in both systems. With this correction in the PHEAA analysis, it is clear that **the Simon-Durenberger plan puts far more of the program's money in the hands of students**

than does the current system.

At the back end (payments on loans), the PHEAA analysis incorrectly portrays IDEA Credit as a rigid program, rather than the flexible program it is designed to be. Because borrowers are not *forced* to make payments over a longer period, as PHEAA assumes, the agency's criticisms lack foundation. **IDEA Credit offers a more efficient collection mechanism which also allows payments to be more sensitive to the borrower's income and family situation.**

The most alarming aspect of the PHEAA analysis is that, in its effort to find fault with IDEA Credit, it ignores a basic economic principle: money changes value over time. PHEAA concludes that a 10-year loan repayment period must be better than a 16-year repayment period (even with a lower interest rate) because when you add up all the payments, you pay less over 10 years. But if that's the case, why stop at 10? Why not 5? Why not 2? Why not pay for college up front and avoid *all* interest costs? The answer of course is *the student can't afford it*. The best loan is one with *affordable payments*. When you're a student or unemployed, you probably prefer to pay little or nothing. When you have a job, you're willing to pay more. IDEA Credit provides this kind of flexibility, allowing borrowers to stretch out payments if they have periods of low income compared to their debt load. PHEAA mistakenly assumes that IDEA *requires* lower payments and longer repayment periods; in fact, IDEA simply *allows* them. So PHEAA's argument is not only illogical, it's irrelevant.

II. THE FRONT END: PROVIDING AID TO STUDENTS

The PHEAA analysis is fatally flawed because it does not evaluate the whole of what Senators Simon and Durenberger are proposing. As you know, the proposal establishes a new loan program, IDEA Credit, as a replacement of the current loan programs. This new program is designed to be self-financing, which means that the funds that would have been spent to subsidize the current loan programs--$2.7 billion in the 1992 fiscal year--are available for other purposes. The Simon-Durenberger bill shifts most of that money into the Pell Grant program. So, in evaluating the two proposals, one must compare the loans that a student would get now, compared to the loans *and increased grants* that he would get under the Simon-Durenberger proposal.[1] As our analyses have previously shown, the result is that most students leave school with less debt under Simon-Durenberger than under the current system:

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[1] As you know, that aspect may change in the amendment that is offered on the floor, to use the funds instead to maintain the in-school interest subsidy. Part B, below, analyzes the program using this more likely scenario.

TOTAL INDEBTEDNESS: Post-college indebtedness for students receiving the same amount of total financial aid (grants & loans) under the current system vs. Simon-Durenberger, at public and private colleges.

	Amount owed after four years of college under:	
	Current System	**Simon-Durenberger**
Low-income family:		
PUBLIC:	**$10,279**	**$8,760**
PRIVATE:	**$28,132**	**$25,793**
Middle-income family:		
PUBLIC:	**$20,946**	**$19,466**
PRIVATE:	**$31,211**	**$29,200**
Higher income family:		
PUBLIC:	**$23,097**	**$21,900**
PRIVATE:	**$32,937**	**$31,633**

Even though students from low- and middle-income families receive an in-school interest subsidy under the current system and not under IDEA Credit, the increased grants and reduced fees under Simon-Durenberger mean that they needed to borrow less money in the first place. For students from higher-income families (who do not receive the in-school interest subsidy in the current system), the amount of indebtedness is lower because the interest rate and fees under IDEA Credit are lower.

A. Borrowing Assumptions

PHEAA says that some of the borrowing assumptions used in the above analysis are too high. Instead, PHEAA's analysis assumes that all students borrow $2500 a year, for a total of $10,000 (yielding $9,200 of usable funds, because of the 5% origination fee and 3% insurance fee). The agency bases its assumption on its data from students at *public* colleges. PHEAA no doubt used this assumption because it makes the current program look better: the amount is just under the loan limits of the subsidized Stafford (on which the government pays the interest during school), so they can avoid showing the build-up of interest on an SLS. In addition, PHEAA errs in assuming that these need-based loans go to students from *higher*-income families, because they would not qualify in the current system. I must assume that the PHEAA data refers to the *unsubsidized* Stafford offered by PHEAA to dependent students whose income is too high to qualify for the subsidized loan. With this correction to the PHEAA assumptions, using the lower borrowing amounts that PHEAA suggests results in the following changes in the preceding chart for "PUBLIC" colleges:

TOTAL INDEBTEDNESS (after PHEAA adjustments)
Amount owed after four years of public college, receiving $9200 in aid:

	Current System	Simon-Durenberger
Middle-income family:	$10,000	$8,760
Higher income family:	$11,610	$11,193

Therefore, making the changes that PHEAA suggests does not change the conclusion that students finish school with less indebtedness under Simon-Durenberger than under the current system.

B. Shifting Subsidies

The government's payment (to the lender) of the student's interest while in school is really just a monthly grant of sorts, equal to the interest that the student would have otherwise had to pay. The Simon-Durenberger legislation shifts this subsidy (as well as the current payments to banks and other savings from direct lending and more efficient collection) into the grant program. What the PHEAA analysis does is compare the current Stafford loan program, with its in-school interest subsidy, against IDEA Credit, without the increased grant aid. So it looks like students leave school worse off under IDEA Credit only because PHEAA ignores the fact that there is $2.7 billion in additional student aid in the system.

At the end of its analysis, PHEAA finally notes its omission and argues that one cannot assume that the same person who would get an interest subsidy in the current system would get a Pell Grant under Simon-Durenberger. While there are such cases, it does not follow that a fair analysis would only compare *borrowers* in each system, as PHEAA does. One should instead compare all *students*, since there are also those who will get larger Pell Grants under Simon-Durenberger, but who would not have borrowed under the current system(and therefore do not lose any interest subsidy). PHEAA's approach is the same as if I were to do an analysis showing *only* the increased Pell Grants, without showing the impact of the elimination of the in-school interest subsidy.

As I will show, there are better ways of analyzing the two proposals while addressing PHEAA's criticism. The key is to fix certain variables, so that we can analyze others. For example, we could ask, How much would it cost the government to provide X amount of student aid under each system? This requires us to assume that the terms to students are equal (interest rates and subsidies, fees, loan limits), so we can find out how the government's costs change *only as a result of the new system*. That is the first example, below.

The other option is to ask, If the government has Y dollars to spend, how much student aid could we get under each system? This requires us to assume that the government has a certain amount to spend, then analyze how much that buys, in each system, in terms of loans (including interest rates and fees) and grants. That is the structure of the original Simon-Durenberger analysis, to which PHEAA objected because eligibility is determined differently for grants and for loans. An alternative approach is to assume that the subsidy, in both systems, is spent *within the loan programs.*[2] That is the second example, below.

1. Analysis of the total government subsidy necessary to provide the same amount of aid to students under two different systems.

This is really just the structure of the analysis that the U.S. General Accounting Office (GAO) did of direct lending. In assessing the comparative cost of a direct loan system, GAO assumed that borrowers would pay the same fees and same interest rates under each system, and that the total volume of lending would be equal. As you know, GAO concluded that the switch to a direct loan system would save more than $1 billion (present value) in the 1992 loan cohort. More recently, the Congressional Budget Office concluded that the direct loans in the House bill will save $950 million compared to what it would have cost to offer them as guaranteed loans.

So that we are comparing apples with apples, let us assume then that the Simon-Durenberger proposal is changed to retain the in-school interest subsidy for qualifying students (remember, this is a policy decision--and probably not an unreasonable political assumption), and the current fees and interest rates are held constant (even though fees and interest rates are *lower* in the actual proposal, just as they are lower in the actual direct loan proposal). We can reach a conclusion similar to GAO's, because the front end of IDEA Credit is identical to direct lending (the source of capital, the elimination of middle players). Furthermore, we can expect greater savings, because collection through the income tax system is far less costly than contracting with servicers, and defaults are significantly reduced, even after accounting for borrowers whose balances are forgiven after 25 years.[3]

As you have already noted in supporting direct lending, the $1 billion-plus that could be gained with these changes can be used to the benefit of students, as the next example shows.

2. Analysis of aid provided under two systems using the same overall government subsidy.

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[2] This is not an unreasonable assumption. Senator Simon, in a letter dated December 5, 1991, indicated that he will likely propose retaining the in-school interest subsidy (particularly if IDEA Credit becomes an option for schools rather than a complete replacement of the current loan programs).

[3] The Congressional Budget Office (CBO) analysis of IDEA Credit concluded that replacing the current programs with IDEA Credit "would save the federal government roughly $2 billion in 1992."

Another way of posing this question is, How much student aid can we buy for $2.7 billion (the FY92 subsidy)? Again, by starting with direct lending, independent analyses have already been done that essentially address that question. Both the House and Senate committee bills use about the same total subsidy cost, according to the CBO analyses. But the product that is purchased with this subsidy turns out to be very different. As the chart below shows, direct lending can eliminate fees and buy lower interest rates, and higher loan limits. Higher loan limits in the subsidized Stafford program are a significant benefit to students who qualify.

Loan terms available under current system vs. direct lending
(with the same total government subsidy)

	SENATE (GUARANTEED LOANS)	HOUSE (DIRECT LENDING)
Stafford loans		
Origination fee	5%	none
Insurance fee	1-3%	none
Interest rate (1st 4 yrs)	9%	8%
Interest rate (last 6 yrs)	variable (T+3.25), max 10%	8%
Loan limit (year 1)	$3000	$6500
Loan limit (year 2)	$3500	$6500
Loan limit (years 3-4)	$5500	$8000
SLS/PLUS loans		
Origination fee	5%	none
Insurance fee	1-3%	none
Interest rate	variable (T+3.25), max 11%	variable (T+3.25), max 12%
Loan limit (years 1-2)	$4000	$4000
Loan limit (years 3-4)	$5000	$6000

Because, as I have already noted, collection and default costs would be lower under IDEA Credit, the terms of the loans could be even better for students than the House bill. But to remain on the conservative side, I will assume only that the terms of IDEA Credit would be identical to the House bill.[4]

Now we can compare the two systems, while holding the subsidy constant. It's clear just from looking at the terms that any student would be better off at the front end with IDEA Credit. How much better off depends on the amount borrowed. Assuming that the student qualifies for a Stafford loan and therefore gets the in-school interest subsidy, after four years of college, the total indebtedness under each system would *always* be less with IDEA Credit or direct lending. For example, a student who needs $3000 in aid each year would owe nearly $13,000 (because of fees) in the current system, but only $12,000 under IDEA. Students who do not qualify for the in-school interest subsidy would find even larger savings because of reduced fees and interest rates. (I expect to prepare new comparison tables based on the proposal that will be offered on the Senate floor. I will get them to you when they are ready).

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[4] It is necessary to make different assumptions about the means of providing the subsidy to students to ensure that only one that there is only one dependent variable: total indebtedness. This is appropriate, since the question of whether to provide a given subsidy through payments on in-school interest or through increased grants is a policy decision and has no impact on the economics of the system used.

III. THE BACK END: PAYMENTS ON LOANS

The PHEAA analysis is incorrect in its description of the repayment plan under IDEA Credit. During periods of low income after college, borrowers are not *required* to reduce their payments and spread them out over a longer period. IDEA Credit is simply designed to recognize the borrower's income and family situation and *allow* lower payments during those periods (and to forgive the balance if that low income status continues for a long period). **This fact completely eviscerates PHEAA's claims**, unless one believes that borrowers should not be allowed, at their own choice, to extend their repayment period.[5]

After making its erroneous assumption, PHEAA then proceeds to use a completely inappropriate method for evaluating different repayment options. Instead of properly discounting future payments in order to determine the present value of any particular repayment plan, PHEAA simply adds up all of the payments over time. This argument is moot (because borrowers may make larger payments if they choose to), but I do discuss it briefly in the section IV.

It should be emphasized that the desire to make the lower, income-contingent payment a required minimum, not a maximum, was an explicit decision on the part of the authors of the bill. As you know, the IDEA Credit program is based on H.R. 2336 by Reps. Petri and Gejdenson. One of the changes made in the Simon-Durenberger bill was to eliminate the early repayment penalty, so that borrowers would not have that disincentive to making larger payments. And a new section was added to the bill explicitly stating that borrowers may pay more than the

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[5] And if this is the case, then the current consolidation options should be eliminated, too. There is some evidence that this is PHEAA's position. Page 4 of the memo states that "The basic problem with the IDEA repayment schedules lies in the fact that borrowers are allowed more time to repay their loans."

The original Simon-Durenberger materials compared IDEA Credit to the basic loan under the current system, and also to the consolidation loan. PHEAA does not even mention loan consolidation in its memo (Doing so would have detracted from the argument that spreading out repayment is always a bad thing to do).

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required payment.[6] This was included so that they can avoid negative amortization, if they choose to in that small minority of cases in which low income and high indebtedness lead to a required payment that does not cover interest.

It must be pointed out that not only are longer repayment periods not unknown in the current system (with consolidation), but negative amortization is also not uncommon. Borrowers who plead with lenders for forbearance during periods of low income or unemployment have the interest added to their principle. Unfortunately, all too often borrowers do not take the time to figure out who owns their loan and go through the steps of proving hardship, so they default. Meanwhile, interest accumulates--and if the system ever finds them, they will have to pay it. With IDEA Credit, the required payment automatically takes account of the borrower's income and family situation. And the borrowers who gets laid off and would default in the current system, upon re-employment would automatically be brought back into IDEA Credit repayment (because it operates through the income tax system).

Just so that everything is clear: The minimum payment amount under IDEA Credit is based on an amortization schedule, with adjustments made according to the borrower's income and family situation (e.g. dependents).[7] Paying lower amounts lengthens the repayment period, except that no borrower pays more than principal plus interest, and any balance due after 25 years is forgiven.

IV. SPREADING PAYMENTS OUT

The foundation of the PHEAA analysis (which, again, is based on the erroneous assumption that students are *forced* to make lower payments) is that it is bad for the borrower to reduce payments by extending the repayment period. The PHEAA memo cites one borrower whose payments would be spread over 16 years under IDEA:

> Their repayment amount will total $22,028, 120 percent more than they borrowed, and 46.3 percent more than they would have had to pay for $10,000 in Stafford Loans.

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[6] Section 459(f)(4) of the bill states that "Nothing in this part shall be interpreted to prohibit a borrower from paying an amount in excess of the amount required to be repaid under this part."

[7] In notifying borrowers of the repayment amounts, it is intended that those who are low income would be informed not only of the minimum, but of the amount that would need to be paid in order to cover interest, and the amount that they would need to pay in order to pay off the loan in a certain number of years. Whether to pay the higher amounts would be up to them, based on their own analysis of their present and future situation.

This argument is absurd. It is the same as making the seemingly scandalous claim that *a Stafford Loan costs 50 percent more than to just pay the $10,000 tuition up front.* Of course, this is no surprise to anyone. People take out loans and agree to pay interest because they either do not have the money at the time, or they expect to have an easier time making money in the future, or both. That's why future costs and benefits must be "discounted" to determine the net present value. Simply adding up payments is meaningless.[8] As a basic economics textbook notes:

> *To evaluate . . . benefit streams, future proceeds (or costs) must be translated into present values. They must be discounted, to allow for the fact that future benefits are less valuable than present ones. The same applies to the evaluation of costs.*[9]

The value of any given payment depends on when it is to be paid. It "costs" more to pay $100 today than to pay that same $100 next year. The easiest way to think about this is to assume that you have the $100 now. You can either pay it today, or you could put it into an interest-bearing account, and next year you would have $105. So if you wait until next year to make the $100 payment, you would have $5 left over--clearly a better option. Another way to think about it is to ask, How much would you be willing to pay *now*, to avoid owing $100 next year? If you simply consider the alternative of putting an "equivalent" amount of money in the bank, that amount would be about $95. That is the *present value* of the future payment.

This is not to say that to delay payments and pay more interest is always a good thing. It depends, of course, on the interest rate, on the current income, and on the expected future income. As an investment in a student's own future, a college loan can certainly make a great deal of sense. At age 25-34, those with associate degrees make on the average 40% more than those with just a high school education. With a bachelor's degree, they make 63% more. With a professional degree, they make three times as much. In fact, given the return on an investment in higher education, most students would heavily discount future payments. *Under IDEA Credit, borrowers have the alternative of extending repayment if they are low income, and if they remain low income for a long period, some payments will be*

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[8] Using PHEAA's method of analyzing future payments on loans, lenders should be eager to purchase my $10,000, 10-year, 8% student loan and offer me instead 20 years of payments at 5% interest. PHEAA's analysis would have me reject that deal, since the total amount paid would be higher than under the 10-year plan. Of course, most rational borrowers would be pleased to take the 5% longer-term loan, but so far no lender has made the offer (at least none that are in business anymore).

[9] The PHEAA analysis ignores this basic fact found in any economics textbook. This particular cite is from Richard A. Musgrave and Peggy B. Musgrave, *Public Finance in Theory and Practice*, McGraw-Hill, N.Y., 1980, p. 184.

forgiven.

V. PUTTING IT ALL TOGETHER

At the front end, with a given amount of government subsidy, the Simon-Durenberger plan puts more of the program's money in the hands of students. (The precise *form* of that subsidy is a policy decision available in either system). To the extent that aid is provided in the form of loans, IDEA Credit offers a more efficient collection mechanism which also allows payments to be more sensitive to the borrower's income and family situation.

STATEMENT BY
U.S. SENATOR DAVE DURENBERGER

HOUSE EDUCATION AND LABOR COMMITTEE
HEARING ON DIRECT LENDING
AND THE HIGHER EDUCATION ACT

FEBRUARY 6, 1992

Mr. Chairman, I want to thank you and the other members of the Committee for allowing me this opportunity to place on the record my own strong support for fundamental changes in the student financial aid system -- the kind of changes that are needed to meet the realities and opportunities facing American higher education as we approach the 21st Century.

I also want to pay special tribute to one of your members, Congressman Tom Petri, who has been my mentor on this issue, and who has devoted much of the last decade to designing a simple, workable, fair way of making student loans available to every American who can benefit from a college education.

And, finally, I want to pay tribute to my Democratic colleagues who are testifying here today -- Senators Paul Simon and Bill Bradley -- two Senators whose commitment to higher education is well known and whose bi-partisan approach to fundamental reform in how we pay for higher education is much appreciated by me and by many others on my side of the aisle.

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Mr. Chairman, today's hearing offers a powerful statement about the interest in -- and growing support for direct loans -- and especially, for direct loans that have their repayment based on the post-college incomes of student borrowers.

The proposal that Congressman Petri and Senator Simon and I have introduced sets up a new student loan program that has both of these essential features:

** money available to students directly from the government -- eliminating hundreds of millions of dollars in administrative expense and red tape;

** and payments based on post-college income made through the IRS -- eliminating billions of dollars in defaults and vastly simplifying how loans get collected.

All the charts and graphs and calculations needed to explain and analyze the IDEA proposal can be boiled down to those two central features, those two sets of advantages, and those two calculations of savings.

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Mr. Chairman, like many of the members of this Committee, a big part of my sensitivity to the rising cost of going to college stems from my own experience as a parent and the experiences of friends in my own generation who also have sons or daughters who are in -- or about to enter -- college.

Just two months ago, a new national survey found the rising cost of college to be our third biggest worry as families in America -- right behind crime and drugs and -- surprising to me, at least -- ahead of health care.

Millions of middle income American families are clearly worried that going to college is something that could again become the province of the unsubsidized rich and the totally subsidized poor.

And, millions of American families are clearly worried that their kids won't have the same opportunities that we had to go to college... just one generation ago.

That reality validates one of the primary lessons of the Generational Equity movement I helped found a half dozen years ago... that my generation will be the first generation to leave its children less well off than we were left by our own parents.

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Mr. Chairman, I also see the dilemma facing middle income American families every day in my mailbag.

As one Minneapolis couple wrote me recently, "Even though our combined incomes are about $60,000, we are finding it hard as middle class citizens to pay college expenses and support a family. We are too poor to be rich and too rich to be poor."

One big reason for this frustration lies with the rising cost of going to college. From 1980 to 1987, for example, inflation adjusted tuition grew at five times the rate of the median family income.

Just three months ago, the papers were again reporting the College Board's annual report on average tuition and fees at public and private universities.

Inflation was three or four percent last year. But, tuition and fees were up 12 percent at public four-year institutions and up 13 percent at two-year public universities, the fastest growing sector of higher education.

All of this is happening at a time when incomes are leveling off, and home equity -- the traditional "savings bank" that many of us drew on to finance our kids' educations -- may even be declining in value.

What scares me about this reality is that it represents a trend that threatens to price middle income Americans out of higher education at the same time economic realities are demanding an even better educated workforce.

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Let me offer just one example -- of how the economics of higher education are changing for one average middle income Minnesota family.

My example draws on the experience of a 42-year-old Minnesotan who grew up in a middle income family and who would have to be considered an average middle income Minnesotan, today.

Twenty years ago, this person attended the second most expensive four-year private college in Minnesota.

And, by drawing on his parents' current income -- supplemented by a small savings account, part-time jobs, and a $250 scholarship in the first two years -- his college education was paid for without borrowing.

The total cost of that four-year, private college education -- again just one generation ago -- was about $12,000, including room and board.

Like many middle income families in a similar situation a generation ago, meeting that obligation required belts to be tightened a notch or two. But, it could be done.

And, that same combination of current family income and work and savings got millions of American students of that generation through college and on their way toward productive lives.

Today this average middle income Minnesotan has three children, ages 12, 9 and three.

And, anyone who can do simple arithmetic can figure out something has to change if those three kids are going to get a college education like their father or mother got just one generation ago.

Projecting current costs out into the future, the total cost of educating those three children will range somewhere between $200,000 -- if all three attend public colleges -- and $400,000 -- if all three attend private colleges.

That's an average of $67,000 for a public college education and $133,000 for private college -- a ten fold increase in what it cost to send our average Minnesotan to college just one generation ago.

A prudent family that cares about educating its kids would start saving for that expense right now. But, using reasonable assumptions, our 42-year old middle income Minnesotan would have to start putting aside more than $14,000 a year if his three children were going to public colleges and almost $30,000 a year to cover tuition and other expenses at private colleges.

So, by the time the three year old enters college in the year 2006, this middle income Minnesotan would have to invest an average of $17,500 per year for 15 years -- to finance the same high quality college education he had just one generation earlier.

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Mr. Chairman, Senator Simon, Senator Bradley, Congressman Petri, and many of our colleagues believe that this 21st Century challenge cannot be met by our current 1960's-era system of student grants and loans.

... a system that's unnecessarily bureaucratic and complex...

... a system that largely neglects the needs of middle income students and their families...

... a system that spends billions of dollars a year on overhead and red tape...

... a system that's vulnerable to administrative and financial problems best documented by last year's collapse of the Higher Education Assistance Foundation (HEAF)...

... a system that's limiting institutional, career and family-related choices for a growing number of students...

... and, a system that's burdening millions of students with inflexible loan payments and a growing level of debt that produced $3.9 billion in student loan default last year.

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In the five years beginning in 1987, Mr. Chairman, federal student loan defaults have cost the taxpayers $11.5 billion.

More than forty cents of every dollar we now spend on the federal student loan program goes to pay off defaulted loans.

And, many of the thousands of borrowers in default are now stuck with a burden and a barrier to getting and sustaining a good start in life.

I ran into one of those borrowers recently in Duluth... a reporter for one of the local radio stations who defaulted on his student loan a few years ago while in a low paying job.

Today, because of that black mark on his credit rating, he and his wife can't get a loan for their first home.

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My mailbag is full of similar sad stories including one Robbinsdale couple -- both in default, but both now having the incomes and future earning potential to eventually pay off their loans.

But, because they are in default, their loans are now in the hands of a collection agency which is demanding payments they can't make.

"We would like to make regular payments,"this couple wrote to me recently. "But, we feel our efforts are denied by the creditors insisting on unrealistic expectations."

The inflexibility of the current system is especially hard on very low income individuals who may have failed the first time around in getting a college education and defaulted on their student loans.

As one advocate for many of these low income defaulted borrowers wrote recently:

"Most of these clients pursued education in good faith, hoping that school would result in a career and a better life. Their circumstances derailed their plans, but when we see them, they remain poor, unemployed, on assistance, and stuck."

"Perhaps most damaging is exclusion from additional financial aid. Thus, they find that the one door to self-sufficiency -- education -- is closed and locked."

* * * * *

That kind of indictment of the current student aid system requires more than tinkering and fine-tuning.

What we really need is a fundamentally different way of both easing the burdens of rising cost and of insuring each of us against the uncertainties of incomes that often rise and fall throughout life.

That two-part challenge is met by legislation that Senator Paul Simon and I introduced in the Senate on October 22.

What we call the "Financial Aid for All Students Act" authorizes an entirely new student loan program that's available to any American up to age 55.

IDEA is a fair, simple, efficient way of assuring financial access to higher education for millions of middle income Americans who don't now qualify for a federally guaranteed student loan.

IDEA offers flexibility in avoiding needless defaults for graduates when their incomes rise and fall because of changes in the economy, career choices, illness, or family obligations.

IDEA offers individuals with relatively low incomes -- like teachers and social workers -- the opportunity to pay off their loans without the unfair burden than now can discourage a public service career.

IDEA is the best and lowest cost solution to the concerns all of us have heard from medical students about the potential loss of deferred interest during long and relatively low-paying residencies.

And, IDEA saves an estimated $2.7 billion per year in inefficiencies and flaws in the current student loan program... money that's now going for overhead and red tape... money that's now going to pay defaulted student loans.

Under the legislation Senator Simon and I introduced last fall, that $2.7 billion in savings would go to students... based on financial need... based on merit... and based on a willingness to participate in programs that improve academic performance.

* * * * *

Mr. Chairman, some of our colleagues might be asking: "How could a liberal Democrat from Illinois and a moderate Republican from Minnesota get together on a single legislative proposal so sweeping, so revolutionary, and yet so deeply rooted in values that promote access, individual responsibility, quality, and excellence in higher education?"

The answer to that question, lies in two essential principles -- principles that aren't Democratic or Republican... principles that aren't liberal or conservative... but principles that represent common sense and what's good for students and what's good for America's future.

The first of those principles, recognizes the reality that higher education today is both more costly and more important.

That principle states that the national government has an obligation to help assure financial access to higher education to every American who can benefit from the rich rewards that higher education can offer.

And, the second principle, Mr. Chairman, is that meeting this challenge will require fundamental changes in a system of financing higher education that's badly in need of reform.

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Before I close, Mr. Chairman, I'd like to address a few remarks to my colleagues in the Administration and to my colleagues on my side of the aisle.

I do that, in part, to respond to another very obvious question: "Why would I introduce legislation that includes direct loans -- a provision that the Bush Administration has said would trigger a veto of the entire Higher Education Act reauthorization?"

In response, Mr. Chairman, I first believe it's very important to point out the important differences between the IDEA proposal and more traditional direct loan proposals including the House legislation and the proposal that the Administration previously considered and then rejected.

IDEA addresses many of the criticisms -- on projected cost savings and administrative feasibility, for example -- that the Administration has made of the House proposal and which cause the Administration to set-aside its own proposal.

And, with its income-contingent feature, IDEA produces real savings from fewer defaults -- savings that wouldn't necessarily occur through a more conventional direct loan program that retains the kind of inflexible loan repayment we now have in the current system.

Of course, the Administration has also expressed concerns about the impact of a direct loan program on banks and other third parties in the current system and the impact of a direct loan program on the deficit.

On that point, I must say I believe the Administration is wrong. The purpose of the federal student loan program is to help provide financial access to higher education, not to offer a guaranteed source of income for banks. If students, institutions, and taxpayers can be better served by a different way of doing things, I say "why not?"

I also distinguish between a direct spending program -- that does add to the deficit -- and a direct loan program that recycles money back into the treasury once loans are repaid. That's a clear distinction that Congress -- and the Administration -- made in last year's budget agreement when we moved the issuance of debt for loan programs like IDEA "off-budget."

Finally, Mr. Chairman, IDEA represents that most basic of "Republican values" -- a clear focus on individual responsibility.

With the kind of improvements in student loan programs contained in IDEA, we focus primary responsibility for financing higher education with individuals who benefit, not on the government.

IDEA loans, after all, do have to be paid back. On the other hand, billions of dollars now being spent on defaults are being lost forever.

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Mr. Chairman, Senator Simon and I have introduced legislation that we believe should be part of this year's reauthorization of the Higher Education Act. We realize these are far-reaching proposals. They are controversial. They confront powerful special interests. They challenge deep-seated ideology.

But, the system we have now, will not adequately serve Americans into the 21st Century. The system we have now must be fundamentally changed.

In its place, the IDEA program offers a solid commitment to ensuring access to higher education for all Americans. I urge your support and I urge the support of your colleagues.

Thank you very much.

U.S. SENATOR DAVE DURENBERGER (R-Minnesota) is a member of the Senate Labor and Human Resources Committee and the Senate Finance Committee.

Senator Dave Durenberger
US Senator for Minnesota

SUMMARY OF MAJOR PROVISIONS IN THE FINANCIAL AID FOR ALL STUDENTS ACT OF 1991

The Simon-Durenberger proposal produces savings estimated at $2.7 billion by eliminating the current Stafford and SLS student loan programs. It uses those savings to:

** Create a new, simpler student aid program called IDEA Credit, available to students regardless of income, with payments made through the IRS and tied to a percentage of income.

** Finance a $600 increase in the current maximum Pell Grant to provide more assistance to those currently eligible.

** Create a new program of $1000 "Excellence Scholarships" for low-income students who work hard and do well in school.

** Provide matching block grants to states to establish early intervention programs for at-risk you, to help prepare them for college and to make them aware of the availability of financial aid.

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Following is a brief summary of these four major provisions. In each case the dollar figure are actual, not simply authorizations. They are "shifted entitlements" as allowed under the Budget Enforcement Act of 1990.

Income Dependent Education Assistance (IDEA Credit)

Beginning with the 1994-95 academic year, the current federal guaranteed student loan programs (except the PLUS loan for parents) would be replaced with new IDEA Credit available to all students regardless of income. Features of the program include:

** Loan maximums: Students are eligible to establish an IDEA account and receive education assistance of up to $6,500 per year for first and second-year undergraduates, up to $8,000 per year for other undergraduates, and up to $11,000 per year for graduate students. Medical and some other doctoral students could receive up to $20,000 or more in some circumstances. Total credit is limited to $70,000 per student (or $100,000 or more for medical and some other doctoral students). Anyone 55 years of age or younger may receive IDEA credit, but maximum loan limits are gradually scaled down between the ages of 35 and 55.

** Interest rates and charges: While a student is in school, interest accrues in their IDEA Account at a rate equal to the 91-day T-bill rate plus two percentage points, up to a maximum of 10 percent. The rate currently projected by the Congressional Budget Office (8%) is lower than all of the current guaranteed student loan programs (Stafford increases to 10 percent after four years). While there is no in-school interest subsidy (as there now is in the Stafford program) there would be no origination fees or insurance (an average of 6.6% up front levy, sometimes as high as 8%, is currently charged to Stafford borrowers and is being considered for the other programs).

** Income-based payments: After the student finishes school and finds work, he or she will begin to make payments to the IDEA account through increased income tax withholding by the employer. The amount of the payments each year depends on annual income, but the intent of the program is to have no borrower pay back more than borrowed, plus interest. Borrowers would not have to make payments in any years in which they do not earn enough income to have to file a federal income tax return. Further, no payment may exceed 25 percent of the difference between actual income and the minimum filing income. Most loans will be paid off in 10-15 years. And, anyone with a balance on their loan still due 25 years after finishing school will have their slate wiped clean.

Expanded Pell Grants

Under the Simon-Durenberger proposal, $2.1 billion of the estimated $2.7 billion in savings is shifted to the Pell Grant program. And, the maximum Pell Grant is increased by $600 above the appropriated amount. This would be on top of any appropriated increase in today's $2400 maximum.

The affect of this increase is that the average size of grants for students who already qualify will increase, and grant eligibility will rise above the current median family income.

Because these savings are being shifted out of an existing entitlement program (largely Stafford loans), current budget rules require the increase in Pell Grants funded by this legislation to be treated as an entitlement to qualifying students.

In addition, a full entitlement is authorized for the entire Pell Grant program, if Congress designates additional savings or revenue for that purpose.

And, finally, first-year graduate students would be eligible for Pell Grants if funds are available after fully funding the authorized grants for undergraduates.

Excellence Scholarships

The Simon-Durenberger proposal creates a new $500 million per year scholarship program to encourage outstanding Pell Grant recipients to work hard in school. Eligible students would receive a $1000 per year bonus on their Pell Grant if they take a challenging curriculum in high school and either rank at the top of their class, perform well on a national standardized test, or participate in a TRIO or other early intervention program.

In order to continue receiving these excellence scholarships at a degree-granting college, recipients must demonstrate high achievement, or, for those who first qualified by participating in TRIO or other early intervention program, continue to make progress toward achieving their goals.

Early Intervention Block Grant Program

Finally, the Simon-Durenberger proposal earmarks $100 million in matching funds to states to establish programs modeled on the "I Have a Dream" effort started by Eugene Lang in New York. The funds would be used to run programs that mentor, advise and tutor at-risk youth. Youth participating in these programs would be eligible for the Excellence Scholarships discussed above.

QUESTIONS AND ANSWERS ON THE FINANCIAL AID FOR ALL STUDENTS ACT OF 1991

1. Where does the money come from that will go into expanding Pell Grants, the Excellence Scholarship, and the state matching grants for early intervention programs?

Replacing the current guaranteed student loan programs with IDEA Credit saves about $2.7 billion per year, which is shifted in these three new programs. By getting the capital for the program directly, instead of paying banks to do it, the federal government saves up to $1.4 billion (according to a new report from the U.S. General Accounting Office). Additional savings come from simpler collection through the income tax system, and reduced defaults. Also, the in-school interest payments that the federal government now makes for Stafford borrowers would, in effect, become part of the increased Pell Grant and new Excellence Scholarships under this program.

2. Doesn't IDEA Credit just increase the federal deficit?

No. IDEA Credit is designed to break even. The Congressional Budget Office has analyzed the proposal on which IDEA Credit is based (H.R.2336, Petri-Gehdenson and S.1645, Durenberger-Fowler) and determined that participants who remain low income after college would, on the average, receive a slight subsidy in the program, while those who are middle and higher income provide a small profit to the government because the interest rate is slightly higher than the federal cost of money and other costs of the program. In reaching the 1990 budget agreement, Congress and the President recognized the distinction in calculating the federal deficit between programs like that eventually break even and programs that directly spend federal funds.

3. Will there be problems in getting capital for this program, like we've seen in the Perkins (or National Direct Student Loan) program?

No. The Perkins program is under-funded only because it is not an entitlement. IDEA credit is an entitlement to the student, like Stafford loans are currently to those who have incomes that qualify. There is nothing inherently more stable about guarantees as a funding source as opposed to direct loans. In fact, there have been shortages in the GSL program in the past (sometimes because of banks' unwillingness to lend) and the current HEAL program for medical students is an example of a guaranteed program with a limit on its overall capital.

4. Will the Department of Education be able to run this program?

Right now, the Department tries to keep track of the thousands of institutions, millions of students, 10,000 lenders, 35 secondary markets, and 45 guarantee agencies. Because of all the players, it takes years for the Department to know how many students at which institutions took out how much money in loans. One indication of this difficulty is that, in the most recent list of defaulted loans, the Department often listed the guarantee agency as "unknown". IDEA, on the other hand, would be run much like the Pell Grant program. Schools would determine eligibility, draw down funds, and then reconcile the accounts. The Department of Education will only have to worry about schools and students.

5. Won't this open up the program to more abuses?

There is no question that, whatever changes are made in the student aid programs, the potential for fraud and abuse will need to be addressed. IDEA would improve accountability in two ways. First, as in the Pell grant program, no school could draw down more than its previous year's allocation without providing additional justification. The current finger-pointing by banks, schools guaranty agencies and the Department of education will end. In the loan programs now, the Department can't tell if a school has an unusual increase in loan volume until it's too late. And, second, defaults will be virtually eliminated, since payments are tied to each year's income and collected through payroll deductions by the IRS.

6. Will IDEA make more work for the schools?

No, in fact, the goal is to require less work of schools -- and certainly a lot less than other, more traditional direct loan proposals. Right now, schools have to process individual applications, receive separate checks at various times (often to different offices on campus) from different banks for each student. They then have to get the student's signature on the check and process a check for the remainder after tuition and fees are paid. Under IDEA, the school would still process applications and get a signature on a promissory note from each student. But, the funds would come in one lump-sum payment to the school for all of the IDEA applicants. And, the school would disburse to the student any funds remaining after tuition and fees are paid.

7. Will this subject schools to more liability?

Schools continue to be responsible for errors they make, just as in current loan program. But, due to the reduced number of players, schools have greater control over the process, and the possibility of mistakes is reduced. Further more, most of the errors that banks make in the current programs are in complying with the "Due diligence" requires in the collection of payments on loans. With IDEA Credit, collection in the responsibility of the federal government, through the IRS.

8. Will student loans still be available over the next two years until IDEA Credit becomes available?

Yes. The current programs stay in place until the new programs begin. A recent study by the Department of Education found that guaranteed student loans are among the most profitable and least risky for lenders. Even after IDEA starts, lenders will continued to get the guaranteed interest rate on outstanding loans, although Stafford and other GSL borrowers will have the option of converting their loans to IDEA Credit. And, any borrowers defaulting on Stafford and other GSL loans will automatically be converted to the IDEA program.

9. Who are the winners and losers under Simon-Durenberger?

Of course banks and others who currently handle some part of federal loan programs that will be eliminated will loose that part of their business now represented by existing loan programs. But, most students and their families will be winners. To what extent individual students are better offer under Simon-Durenberger depends on a multitude of factors including current and future income, tuition rates they pay, how many years they attend school, and whether they qualify for an "Excellence Scholarship." The attached tables attempt to estimate the effect of the IDEA program and the Pell Grant expansion and "Excellence Scholarship" programs on 12 different students. Following those tables is a listing of assumptions used in making these calculations.

10. Didn't President Reagan and Education Secretary Bill Bennet propose something like IDEA years ago. And, wasn't the demonstration that ended up being enacted considered pretty much a failure?

President Reagan and Secretary Bennet did propose an income contingent loan program but it was part of a $600 million cut in campus-based grants and loans and most people in the education community opposed it on that basis. Both the New York Times and Washington Post endorsed the income contingent concept, while opposing the aid cut that went along with it. The Simon-Durenberger proposal, on the other hand, includes a significant increase in grant aid.

As far as the ICL demonstration program that came out of the original Reagan-Bennett proposal, by most accounts, there have been a number of problems. But, none of the problems with the demonstrations apply to IDEA. For example, the ICL demonstration program requires schools to collect copies of income tax forms to determine the students' payments, and the school does the collection. With IDEA, the IRS is responsible for collection. Under the demonstrations, some ICL borrowers will also be indebted for life. Negative amortization (resulting from payments that are less than interest charges) can lead to someone never being able to repay a loan if he or she remains relatively low income throughout life. IDEA addresses this problem by forgiving any amount still owned after 25 years and by capping interest rates at 10 percent. The ICL demonstrations also have no minimum income protection. That means that people who make so little that they don't even have to file a tax form must file anyway and then make a payment. Under IDEA, those under the filing threshold would owe nothing in that year.

11. Do high income borrowers have to subsidize low income borrowers by paying more than they owe?

No. The intent of IDEA is that no one pay back more than what they borrowed plus interest.

12. If there's no high income penalty, then how can this program be self-funding?

IDEA charges borrowers interest at rates 2% above what it costs the government to borrow that money. This "profit" to the government is used to subsidize low income borrowers who have their loans forgiven after 25 years and to pay other expenses of the program. Those expenses are much lower under IDEA because of its simplicity. And, two big expenses of current programs -- defaults and in-school interest subsidies -- are largely reduced or eliminated.

13. Shouldn't parents take more responsibility for financing their children's education, instead of forcing debt on the young?

For most middle and upper income families, there will still be a strong incentive to make a maximum family contribution, in order to hold down borrowing and interest payments over time. And, the IDEA proposal also encourages parents to pay their share by requiring that they be notified of their ability to borrow in the PLUS program before a dependent student can take IDEA Credit. On the other hand, many parents are already seriously strapped and -- with the rising cost of tuition -- simply can't make the kind of contribution to paying for college that we've expected in the past. And, finally, a growing percentage of students are older can't count on parents for support. Those "non-traditional" students also have much higher expenses than 18-22 year olds -- for child care, housing, and other expenses.

14. Society benefits from the higher education and job training that students receive. Shouldn't society pay, instead of students, for higher education?

Both society and the students benefit, and -- under Simon-Durenberger -- both continue to take some responsibility for paying through a more equitable mix of loans and grants. Clearly, post-college income is a good indicator of the value of an education, however, and that's one good reason for having loan payments based on post-college earning levels. For example, at age 25-34, those with associate degrees make on the average 40 percent more than those with just a high school education. With a bachelor's degree, they make 63 percent more. And, with a professional degree, they make three times as much as a high school graduate.

15. Will larger grants and "easier" borrowing lead to higher tuition?

Clearly, the rising cost of higher education is of great concern and no new program like IDEA that makes borrowing "easier" should be viewed as authorization to colleges and universities to pay no attention to costs.
To reduce any incentive on the part of institutions to raise tuition, the loan amounts allowed under IDEA are limited to the cost of attendance in 1991-92; and there is no automatic indexing for inflation. After the program starts, the Secretary of Education will report to Congress on the effects of the program on tuition, and the effects of inflation on the loan amounts and repayment provisions. The Secretary, in consultation with Congress, will make adjustments in loan limits after the first two years of the program.

16. Won't the fear of debt deter low-income students from participating?

Low income students will be provided with more aid in the Pell Grant program under Simon-Durenberger, including the extra $1000 bonus grant available to outstanding students under the Excellence Scholarship program the legislation creates. Also, low-income students fear debt because they do not know if they will make enough money to make payments. IDEA Credit addresses that problem by making payments sensitive to income.

17. Why create the Excellence Scholarships and early intervention program as entitlements?

Under the Budget Enforcement Act of 1990, entitlement funds (like those in the Stafford program) can only be shifted into other entitlements. The Excellence Scholarships and the early intervention program are "capped" at $500 million and $100 million, respectively, so that they will not result in the same kind of unexpected spending that other types of entitlements -- such as Medicare -- can entail.

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For more information, contact U.S. Senator Dave Durenberger, 1020 Plymouth Building, Minneapolis, Mn. 55402; 612-370-3382.

Mr. **Sawyer**. Thank you very much, Senator. I had one question based on my failure to understand what you were saying when you talked about the option for schools.

Mr. **Simon**. Yes.

Mr. **Sawyer**. Were you suggesting that this is an either/or situation or that the current programs are compatible with what you propose?

Mr. **Simon**. This is the area where we may be able to work out compromises. What I frankly have suggested is that schools have one or the other. I think very few schools are going to want to choose the present system if they're given the option. And for those who say it's going to cost the students more, one of the ways the calculate it's going to cost the students more is they assume that we require them to pay for the full 25 years. First of all, you stop when it's paid. And if anyone wants to pay up in advance they can pay up in advance.

But because of the additional assistance—you have some schools from Sam Gejdenson's good State of Connecticut right over here, if you were to ask the president of Wesleyan what percentage of the tuition that he now uses to help other students, it would be a considerable amount. If we can lift the amount that we give to students we are going to help schools and we're going to have tens of thousands of additional people going to school.

George Miller was here on this committee when we passed the Middle Income Students Assistance Act. And while there were abuses, we opened college up to a lot of people in this country. It paid off tremendously. If we, once again, expand opportunity in this country it's going to pay off, just as the old G.I. Bill did.

Mr. **Sawyer**. Mr. Petri?

Mr. **Petri**. It's Paul Simon. I feel you should be up here because this is where you used to be.

Mr. **Simon**. I would be happy to give you my proxy.

[Laughter.]

Mr. **Petri**. I really don't want to ask a question. I just wanted to thank you very much for taking this issue on and displaying tremendous leadership and commitment to it. It's always tough making changes in any sort of program that's been established for a long time, but it's terribly important. I think we do have a window of opportunity here. But it's not going to just happen in and of itself. You've been just tremendous in the Senate and I'm looking forward to working with you as we move forward.

I think our approaches are very similar and they're all headed in exactly the same direction. And between now and conference, hopefully there will be plenty of opportunities to sit down and work through these various details, such as school options or high income premiums or poverty level where you don't pay, and various things like that which we really need to work on at a tactical level.

You've been mobilizing the higher education community and have displayed real leadership in this area. I thank you very much.

Mr. **Simon**. Thank you.

Mr. **Sawyer**. Mr. Miller?

Mr. **Miller**. Mr. Chairman and Paul, thank you very much for your testimony for the bill. I think it's fair to say that in the last few days, certainly on this side there has been a renewed interest in this concept, whether it's Bradley/Miller or Simon/Petri/Gejdenson. And I think it's incumbent upon those of us that have invested some time in this to start to look toward that compromise vehicle.

One of the geniuses of the American competitive system has been to create instruments of finance so that businesses can expand and opportunities can expand. And we have now a system, the higher education system, that is tied to a very old, outdated system of finance and we have got to bring that current. And that's really what this legislation is about when we look at both the financing of higher education, the participation in higher education, and the troubles and the pressure that the institutions are under.

So I think we have an opportunity here. In my discussions both with the leadership and with other committees, it's fair to say that this is being looked at very seriously. And so if we have the opportunity to narrow the differences and present this package, not only do I think we will have bipartisan support but I think we will have the support of all of the relevant committees to pursuing this effort.

So I am excited to participate and appreciate all the interest. And I know some of the battles that you have been through on the other side of the Capitol and I think it's serving us well for this concept. Thank you.

Mr. SIMON. I thank you. As usual, I agree with George Miller.

Mr. SAWYER. Mr. Payne?

Mr. PAYNE. Thank you very much. I certainly won't prolong your stay, Senator, since the fine Senator from New Jersey took so much of your time, so I will be very brief.

Mr. SIMON. These New Jersey people do that all the time.

[Laughter.]

Mr. PAYNE. It's always a pleasure to see you and to hear your very progressive thoughts. And I certainly support the concept. As I indicated before, I think education is going to be the way out. In my opinion, once we correct the educational deficiencies we will see that people will be self-reliant. People want to work. People don't want to be dependant but we have to prepare them so that they can be self-reliant.

So I am just 100 percent supportive of just one additional great idea that you have. Thank you.

Mr. SIMON. I thank you.

Mr. SAWYER. Mr. Andrews?

Mr. ANDREWS. Thank you, Mr. Chairman. Senator, I also want to thank you for this very clear and inspiring testimony. We're very fortunate to have people like Chairman Miller and Congressman Petri who have been talking about these things on our committee, and, doing more than talking about them, educating us about them. You've supplemented our education this morning. I appreciate that.

I have found that this discussion can be divided not by Republican versus Democrat or any ideological barrier but by those who are thinking about principles and those who are thinking about programs. We can talk about tinkering with the existing programs, changing a little bit of this and changing a little bit of that, and that's interesting, but not very productive.

I think what you are doing this morning is talking about the principle that opportunity to higher education is something we believe in, and it should be universally extended and that the universal extension of that principle makes the whole country better and the whole economy better. It's not simply an individual good, it's a public good.

A lot of people acting in good faith, who are experienced and know a lot about this subject, certainly more than I do, are interested in some of the administrative question marks or administrative unknowns in shifting to a system that is characterized, as you put it, by universal eligibility, direct lending, and income contingency.

The voices that I hear, that are concerned, are aid administrators, university administrative officials, college administrative officials, people who have to deal with these problems on an administrative level every day. I think it's incumbent upon those of us who share a desire to make fundamental change in this system to open the door to the people who have those concerns and address some of them.

How would you, in a minute or a few minutes, talk about ways that we might address the administrative concerns of schools and colleges and universities under the new system? What kinds of things can we do to answer those questions?

Mr. SIMON. First of all, I would point out that the college business officers association—I forget the exact name of it—they have gone on record in behalf of direct lending saying this is going to save them a lot of work.

Generally speaking, the colleges that are coming up and saying it's going to mean a lot more paperwork have been told that by banks and the lending institutions. And my answer to them is if this is going to mean so much more paperwork, then you continue with the present system. We're going to give you the option. So we're not going to do any harm to you.

But we're talking about, depending on where we come up, I assume we're talking about at the earliest the 1993-1994 school year. So we have plenty of time to work out the details with the IRS.

I also think that we ought to, as part of the final package—and this is not part of my bill right now—I think we ought to create an ombudsman somewhere where schools and students and former students, if someone says, "They're taking too much money out of my check on withholding," or a college is having trouble getting a payment, that we can get that resolved.

But in terms of the practical way it works for a college or university, it works the way the Pell Grant does right now. The school fills out the form. They estimate what the Pell Grant amount is going to be. The school gets a check and then they have to adjust depending on the number of students. And for our program students sign a note; those notes are sent in; the school estimates what it's going to be; they get a check; then there is an adjustment. And if they're $10,000 too high or $10,000 too low, you take care of that.

Mr. **Andrews**. Let me ask you a narrower question. One of the concerns I've heard if we go to a phased-in program or a choice program like you've described, where an institution can choose to do direct lending or the present program, is the differences in loan limits under the Stafford Program versus the new program; Stafford limits are lower under present law than the new program limits would be, and institutions feel that it would automatically put them at a competitive disadvantage.

What would you think of the idea, under your choice idea, of equalizing loan limitations by cutting the special allowance to the banks under the existing program in order to fund the higher loan limits?

Mr. **Simon**. I guess my immediate reaction is negative.

Mr. **Andrews**. The banks have the same reaction.

Mr. **Simon**. And I do it because frankly, given the choice, I think very few schools are going to continue with the present program. They're going to go to a program that provides greater opportunity for everyone.

And we limit it to treasury rate plus 2 percent, and that, in fact, according to CBO estimates, will be less than the interest that the Stafford Loan now provides. So the students ultimately save in the interest side, too.

Mr. **Andrews**. Thank you, very much.

Mr. **Sawyer**. Mrs. Unsoeld? Mr. Reed?

Mr. **Reed**. Thank you. Senator, again congratulations on your efforts to help us move forward on this issue.

Mr. **Simon**. It's a good Rhode Island tradition that you lead on education. I'm happy to see you here.

Mr. **Reed**. Thank you, Senator. One question in terms of your model of choice, there's a real question of who chooses and you selected the schools to be sort of the focal point of choice.

Mr. **Simon**. That's what we're talking about right now because it is somewhat simpler, but this is an area where I think compromises can be worked out.

Mr. **Reed**. I guess one problem or potential issue would be some students who might have preferences about or exigencies that would force them to go to one institution over another because they could access bigger loans, as Rob suggested, one school versus another. And I don't think that should be something that should influence ultimately the choice of the student.

I know it's a complicated issue, but are you thinking about different modes of choice?

Mr. **Simon**. By having it self-financing, in fact, you can provide appreciably more assistance though this method. But maybe you have another problem: what about those who are in the present program and in the middle of 4 years chipped over to another program; they're going to then be owing money. So there are some practical things that we have to work out but I don't think they should be barriers to seeing that we create more opportunity for students.

Mr. **Reed**. Thank you, Senator.

Mr. **Simon**. Thank you.

Mr. **Miller**. [presiding] Paul, thank you very much for you time.

Mr. **Simon**. Thank you, great to be with you again. Thank you.

Mr. MILLER. Mr. Gejdenson?

STATEMENT OF THE HONORABLE SAM GEJDENSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CONNECTICUT

Mr. GEJDENSON. Thank you, Mr. Chairman. It's nice to be here. I'm not going to take much of your time. I would like to ask that my entire statement be included in the record.

Several college presidents from Connecticut are here today—President Sandell from Mitchell Community College, President Chase from Wesleyan.

As I was thinking about the bills, I thought about the rising cost of college. The University of Connecticut today costs about $10,000 a year, as does Mitchell. Wesleyan, I believe, is over $20,000, Yale is $24,000, and Somers is $42,000. Now, a lot of you probably haven't heard about Somers. It's not a normal university; it's one with bars. It's our State penitentiary.

The amount of money this society is willing to spend on prisons is phenominal. Nobody has ever asked us to worry about the financing system when there's a prison bill on the floor. Yet, when we can set up a process that avoids people ending up in prison, we all of a sudden get into a panic over the financing.

My choice, if we didn't have the realities of today, would be universal college education. In 1635, the Boston Latin School looked around and said it was better for our entire community if every kid in Boston gets a college education.

What we should have done is looked around a long time ago and recognized the world has changed. In almost every academic area we are 70 years behind where we should be. There is so much more information that the average person in society needs to know in order to survive. Somebody was once doing a speech and they talked about how often information doubled. It used to take 100,000 years and then 5,000 years and now we're down to 10 years.

And so to sit back and to say that the way for this society to be competitive is to have our youth only stay in school until they are 16 years old is complete lunacy. Further, it is just as insane to think that you can inspire poor children from inner cities or by telling them if you work real hard you can either borrow $80,000, $90,000 and go to Wesleyan or Yale or you can hang around on a street corner with a real good diploma.

When we look at the examples in society where a couple of healthy individuals who were generous enough to offer kids a free college education we find that the offer changed their lives in two instances. These cases, funded by Louisiana oilman Patrick Taylor and Eugene Lang in New York made all the newspapers and magazines.

It is important to note that these miracles occurred where the crime rates have gotten worse, the drugs are worse, there are more rats, the housing units are deteriorated, and there are more single parents. Yet, because of two wealthy individuals, school systems where the dropout rate is usually 50, 60, 70 percent, 80 and 90 percent of the kids are in school because there is a hope of going to college.

Our business here, it seems to me, is simple. You all know the numbers on the incredibly high default rate as well as the political problem in funding education when every several years a candidate for President decides he wants to spend more time talking about the 11 percent of the kids that default rather than what society gets back from investing in education. Again, the ideal situation to me is if a student has the ability and you can get accepted at a college, then you should be able to attend. Unfortunately, that's not the reality today.

So, what's our choice? As a cosponsor with Mr. Petri and his bill, and with Mr. Miller and his bill, I feel there are very few differences in the bills that need to work out. The loan limits in the Petri bill are a little higher. I believe we should stick with those higher loan limits because, first of all, they are going to try to work us down through this process. Secondly, I want that kid who grows up in the housing project in Middletown to be able to sit down and not worry about somebody being generous.

If a student works hard and gets As in their high school, I want them to say, "Yes, I can go to Wesleyan." I don't want them to have to worry about finding a rich person to take care of them If they can get into Wesleyan, they should be able to get a $70,000 loan and pay for their degree.

Again, with Mrs. Unsoeld, if we had a first choice, I think we could get rid of some off the other programs, but we don't need to do that. I think this one makes so much sense it will end up towering above all the others. You and I, George, have worked on this for some time, as I have with Mr. Petri. We've got strong support in the Senate. We need to press both sides of the aisle to make sure this is included. It's also a critical time to do it. As all of this unemployment is happening, the displaced workers from defense industries will need these loans to get the retraining they deserve.

You know, during good times when a person gets laid off, his or her instincts would be to go immediately back to work. Well, during the difficult times we're experiencing now, there are not say aren't a lot of good jobs out there. So this is the maybe now perfect time for people to take a step step forward and finish college. We can help them do this.

Thank you for giving me some time. I know there are other witnesses. I don't want to take up too much more time. So I'd be happy to answer questions, if there are any.

[The prepared statement of Hon. Sam Gejdenson follows:]

TESTIMONY
BY
THE HONORABLE SAM GEJDENSON
BEFORE THE SUBCOMMITTEE ON POST-SECONDARY EDUCATION
HEARING ON INCOME-CONTINGENT STUDENT LOAN PROPOSALS
H.R. 2336 AND H.R. 3050
FEBRUARY 6, 1992

Chairman Ford and Members of the Subcommittee, thank you for allowing me to testify today in support of the two income-contingent student loan proposals introduced by my colleagues, Congressman George Miller of California and Congressman Thomas Petri of Wisconsin.

I would like to take this opportunity to urge the Subcommittee to consider implementing an income-contingent plan when revamping the student financial aid system this Congress.

As the cost of college continues to escalate, more and more students are finding that they lack the resources they need to pay for a college education. This inability to find the financial means necessary to attend college has severe repercussions on today's youth. Without the hope of attending college, low- and middle-income students have no incentive to do well in elementary or secondary schools. High drop-out rates and poor attendance are the result.

An experiment going on in one of the poorest school districts in the country shows that when middle school students are given the financial means to attend college, they become better students. Located in New Orleans, this is a school district where students usually have little hope of graduating from high school, let alone aspirations of going to college. In 1988, however, a wealthy Louisiana oilman named Patrick Taylor decided to give a few of the children in this school district a chance. He promised 183 seventh and eighth graders in New Orleans that he would pay for the college education of any student who wished to go. The results have been dramatic--almost all of these students are still in school today and making good marks. Eugene Lang, a businessman from New York, also tried this type of experiment with a similar success rate.

Unfortunately, we cannot always rely on one or two wealthy philanthropists to give America's poor and middle class a fighting chance. It is essential, therefore, that Congress act to implement an income-contingent plan which gives all students the opportunity they deserve.

Although the Miller and Petri plans have different financing mechanisms and loan repayment schedules, they do share some common advantages which I believe would be beneficial to our nation's students.

First of all, both plans ensure that anybody who wants to go to college will be able to get loans they need to finance their education. The two bills increase access to college since a student would not be required to meet a financial means test to be eligible for the loans.

Secondly, loan defaults, which last year alone cost the federal government well over $2 billion, will be greatly reduced.

Since loan payments will be collected by the IRS as income taxes there will be less opportunity to default.

Another benefit would be the savings which will result from removing banks from the student loan system. Currently, student loans are financed by using private capital from local banks, for which the government is charged market interest rates. Through these programs, students would receive loans directly from the government. This direct lending would remove banks as the middle-men in the student loan business. Therefore, the cost would be equivalent to the interest paid on government bonds of comparable maturity, which typically is much lower.

In closing, I would just like to point out that there are some aspects of the Petri bill that I hope the Subcommittee will include in any income-contingent loan package. First of all, the higher loan limit of $70,000 in H.R. 2336 will give more flexibility to students when choosing schools and offer them a fairer repayment schedule. Even though the Miller bill has a lower loan limit because it acts as a supplement to the Stafford loan program, I believe its repayment schedule will unduly burden borrowers with low incomes after graduation. Under H.R. 3050, for example, when a person's income is zero, they will still have to make payments on their loans as if they were making 66% of the average college graduate income. In addition to that loan payment, the borrower would also have to make payments on any Stafford loans he or she may have taken out. This type of loan burden would be avoided under H.R. 2336 since a person with an income below the IRS filing threshold would not have to make any loan payments until his or her income was higher.

I encourage the Members of the Subcommittee to carefully consider the best aspects of these two plans as they make changes in the current financial aid system. These types of plans give all students the same chance as those kids in New Orleans and I hope the Subcommittee will view them positively.

Mr. **Miller**. Thank you very much for your testimony. Mr. Petri?

Mr. **Petri**. Sam, I just want to thank you very much for your grabbing hold of this and working so hard on it. I think it's very important that it be, as it has been so far, a bipartisan effort on both sides of the Congress. So, we're just hoping to get a few more on board down at OMB and the Education Department.

Mr. **Gejdenson**. Well, I don't think we can hold our breath for OMB.

Mr. **Petri**. No, but I think they yield to reality, too. If we keep working on this and get it in good shape, which I think we're doing, this is a great improvement.

Mr. **Gejdenson**. You know, the IRS, with its reluctance—boy, the IRS doesn't have any reluctance to get involved in drug deals, you know, assets, figuring out where the guy got his money, whether you ought to confiscate his house. It seems the IRS ought to be ready to step forward here.

Mr. **Miller**. Mr. Andrews?

Mr. **Andrews**. Thank you very much, Mr. Chairman.

Congressman Gejdenson, thank you, not only for your substance of your comments but for your enthusiasm. I think those of us who have been working on this issue——

Mr. **Gejdenson**. It's hard to keep Miller awake, so I'm doing everything I can.

Mr. **Andrews**. Well, you kept us all awake, and we appreciate that. Those of us who have been working on this throughout the reauthorization, you can get a little bogged down on the details. But what's going on here is really important. It's about millions of people across the country and whether they're going to get an education or not. Unless we're willing to do something that is different and radical and bold, they're not. That is something worth getting enthused about. I hope we can all be as enthusiastic as you are. Thank you for your commitment this morning.

Mr. **Miller**. Mr. Reed?

Mr. **Reed**. I just want to commend my colleague from Connecticut and ask him to continue to work on this project and also the underwater classroom project we're engaged in. Thank you.

Mr. **Gejdenson**. Thank you.

Mr. **Miller**. Thank you very much, Sam. Thanks for all your help.

Next, we'll hear from Mr. Michael Bigelow, who is the Deputy Assistant Commissioner from the Internal Revenue Service. Mr. Bigelow, welcome to the committee. Your prepared statement, if you have one, will be placed in the record in its entirety. You proceed in the manner in which you're most comfortable. To the extent that you want to react to other things that have been said, since there's been some discussion of the IRS, certainly feel free to do so also. Thank you.

STATEMENT OF MICHAEL S. BIGELOW, DEPUTY ASSISTANT COMMISSIONER, RETURNS PROCESSING, INTERNAL REVENUE SERVICE; ACCOMPANIED BY JIM HELM, DEPUTY ASSISTANT COMMISSIONER, COLLECTION, INTERNAL REVENUE SERVICE

Mr. **Bigelow**. Thank you, Mr. Chairman.

It's interesting to come forward under so much interest in IRS's position on this. I do appreciate the opportunity to testify on the proposals that would have the IRS collect repayments on student loans. With me today is Jim Helm, the Deputy Assistant Commissioner for Collection. I appreciate you putting the entire statement into the record.

Right now we are working with the Department of Education to examine the issues of mutual concern raised by this bill. My testimony today will discuss the issues and concerns we see at this early stage of inquiry. They are not meant to convey a judgment on our part that these problems are insurmountable, nor that we are opposed to or do not want to do this, as I heard some testify.

While I will not comment on the policy, I must point out that the proposal to have the IRS collect student loans would be a fundamental change in the mission of the Internal Revenue Service and our role in the lives of taxpayers.

Before I comment on the legislation, I would like to give you a little background on the size and scope of IRS operations. The Internal Revenue Service affects the lives of almost all Americans.

During 1991 alone, the IRS processed more than 200 million tax returns and more than a billion information returns. We sent out refunds to more than 80 million taxpayers, and collected more than $1 trillion.

The IRS has a longstanding commitment to making the tax system simpler and more responsive to the needs of taxpayers. Because even minor changes can have a substantial impact on the overall tax administration system, it is important to carefully consider any changes that would affect our ability to collect the more than $1 trillion owed to government each year. In analyzing any new proposal, we must consider its impact on both taxpayer burden and complexity.

The IRS already collects non-tax debts owed the Federal Government. Congress first authorized the collection of delinquent child and spousal support payments through offset of taxpayer refunds in 1981. Refund offset was expanded in 1984 to other Federal non-tax debt, such as unpaid student and small business loans. Because of concern that collection of non-tax debt could affect compliance with the tax laws, Congress directed the Treasury to study the impact of these offsets on future compliance.

The long-term effect is the subject of a 5-year study that we are now conducting. We expect to publish interim results later this year and final results in 1994. The study will also estimate the cost of the program, including any increase in the cost of collecting the tax debts. It will also estimate revenue lost as a result of subsequent taxpayer noncompliance.

The refund offset program has been successful in securing past due Federal debts. In 1991 alone, IRS offset over 1.5 million refunds and secured over $900 million for Federal agencies. Of that amount, over $360 million was for defaulted student loans, which was remitted to the Department of Education.

Taking into account all of these factors, Congress and the administration must ultimately make the policy decision whether IRS should become the collection agent for all Federal debts. Let me explain. Under the IDEA proposal, as we understand it, Congress would move from requiring IRS to act as a debt collector of last resort to establishing IRS as the primary Federal debt collector for student loans.

While IDEA speaks only to collecting student loans, it seems likely that this concept, once begun, would eventually be extended to other non-tax Federal debts.

Above and beyond the policy decision on whether IRS should become the government collector for all Federal debts, we have some very practical concerns about the feasibility of such a proposal. These reservations stem from an analysis of the impact of the IDEA proposal on: first, the ability of taxpayers and employers to cope with the changes; our current tax processing system limitations; our revenue accounting system; and, our tax collection activities. Moreover, we currently have neither the computer capacity nor the resources to undertake such an effort at this time.

The IDEA proposal would have a significant impact on the Service's current processing system. Implementing the provisions would require substantial forms and processing changes, increased capacity, new accounting routines, and greatly increased collection enforcement resources.

Former Commissioner Goldberg and other IRS executives testified last year before both Houses of Congress about the need to modernize our tax system. We are at a crossroads at the IRS. Our outmoded systems make it difficult for us to properly store, timely deliver, or update information already in our system. If the IRS is to be charged with collecting non-tax debts, we would need to begin planning for this as part of tax systems modernization.

To implement this legislation, the Form 1040 would have to be revised to calculate loan repayment amounts due and to record loan payments transmitted. Adding a new line to the Form 1040 is much easier said than done. The IRS would have to adapt several systems to process IDEA accounts. IDEA accounts would have significant difference from current tax accounts. As an example, tax accounts are generally kept in active files for only a few years, although unpaid tax accounts are kept for 10 years. A delinquent IDEA account could be active for 25 years or longer.

As we contemplate processing changes for 1993 and beyond, we are confronting very real limits to our ability to capture information from the 1040. Modifying the computer record that is built from the Form 1040 to transmit information to our Individual Master File to accommodate loan payment information would require format changes which would create unacceptable overhead, severely impacting processing times, making it harder to issue refunds on time.

There would also be a tremendous impact on Taxpayer Service sites and service centers responding to inquiries on subsequent notices that we would send out each year during our busiest season. In addition to the processing issues, which we feel are significant, additional workload would be incurred in our collection function. The collection of delinquent student loan payments would add to the very sizable existing accounts receivable inventory. I've outlined the collection process further on pages 10 through 13 of my prepared statement.

The bill envisions that the student loan payments would be paid along with an individual's current year's tax. However, it does not seem to anticipate altering withholding tables and estimated tax worksheets to ensure that taxpayers pay in the amount that would be due for student loans in advance.

We must note that the bills do not have specific effective dates nor do they contemplate a transition period. I about fell off my chair when I heard 1993. From our preliminary analysis, start-up costs would be significant. If the IRS were also to take on the responsibility for developing a loan processing program, which we are not experienced in administering, lead time, significant lead time, and resource needs would increase.

In conclusion, I agree with the Honorable Senators Bradley and Simon. I do not want to convey the impression that IRS would not be able to collect student loan repayment if that is the will of the Congress and the President. However, I must emphasize that this would be a major change in the way we do business and would impact many different aspects of our current tax administration system.

We know that with proper planning, we can implement major tax legislation. We have done so in the past, and we expect to make major changes in the very near future. As I noted at the beginning of my statement, we will continue to work with the Department of Education to pursue these issues in greater detail and in a variety of scenarios.

We appreciate your taking this opportunity to determine what the impacts on the IRS would be as you consider this legislation.

Mr. Helm and I will be pleased to answer any questions you or members may have.

[The prepared statement of Michael S. Bigelow follows:]

STATEMENT OF
MICHAEL S. BIGELOW
DEPUTY ASSISTANT COMMISSIONER (RETURNS PROCESSING)
INTERNAL REVENUE SERVICE

BEFORE THE SUBCOMMITTEE ON POSTSECONDARY EDUCATION
HOUSE COMMITTEE ON EDUCATION AND LABOR
FEBRUARY 6, 1992

Mr. Chairman and Members of the Subcommittee:

I appreciate the opportunity to testify on the proposals that would have the IRS collect repayments on student loans. With me today is Jim Helm, the Deputy Assistant Commissioner for Collection.

I. OVERVIEW

We have done a preliminary analysis of our responsibilities under Congressman Petri's bill, the "Income-Dependent Education Assistance Act of 1991" (HR 2336). My testimony today is based on that analysis and our experience with collection of non-tax debts. We are working with the Department of Education to examine the issues of mutual concern raised by the bill. My testimony today will discuss the issues and concerns we see at this stage of our inquiry. They are not meant to convey a judgement on our part that these problems are insurmountable.

I also will not comment on the policy. However, I must point out that this proposal to have the IRS collect student loans would be a fundamental change in the mission of the IRS and our role in the lives of taxpayers.

SIZE AND SCOPE OF IRS OPERATIONS

Before I comment on the legislation, I would like to give you a little background on the size and scope of IRS operations. The Internal Revenue Service affects the lives of almost all Americans. Our taxpayer base includes all individuals, families, businesses, trusts, estates, tax exempt organizations, and government agencies throughout the United States, and others throughout the world who do business in the United States. Our budget for FY 1992 is almost $6.7 billion and we have over 115,000 employees in our service centers, call sites, district offices and overseas posts of duty.

During 1991, the IRS processed more than 200 million tax returns and more than 1 billion information returns, sent out refunds to more than 80 million taxpayers, and collected more than 1 trillion dollars. We sent out more than 8 million notices to taxpayers who made math errors, or forgot to sign or attach schedules to their returns; sent out more than 2 million notices requesting name and Social Security Number and received more than 40 million letters in our service centers. We handled more than 36 million calls in our Taxpayer Service call sites and received more than 3.6 million calls and placed more than 3.2 million calls in our Collection Automated Call Sites.

We enforced compliance with the tax laws by conducting more than 1 million examinations and sent out more than 4 million notices to taxpayers who did not include all of their income on their returns. We also sent out more than 18 million balance-due collection notices and initiated more than 4 million collection actions (ranging from filing notices of tax lien to bank levies and property seizures).

To support all of these activities, IRS employees requested copies of more than 40 million tax returns from archives for our use, and received more than 6 million requests from taxpayers for copies of their returns. We made more than 54 million inquiries to our master files and effected more than 700 million transactions to master file accounts.

THE NEED FOR TAX SIMPLIFICATION

The IRS has a longstanding commitment to making the tax system simpler and more responsive to the needs of taxpayers. Our goal is to provide quality service to taxpayers at all times. Because even minor changes can have a substantial impact on the overall tax administration system, it is important to carefully consider any changes that could affect our ability to collect the more than one trillion dollars owed the government each year. In analyzing any new proposal, we must consider its impact on taxpayer burden and complexity.

Congress has legislation pending before it that would simplify the tax rules and reduce the reporting burden on taxpayers. These carefully considered proposals are a very important step in the right direction -- a step that will, if enacted, bring about a positive change in taxpayers' perception about the equity and fairness of the overall system.

II. COLLECTION OF NON-TAX DEBTS BY IRS

The IRS already collects non-tax debts owed the federal government. Congress first authorized the collection of delinquent child and spousal support payments through offset of taxpayers' refunds in 1981. Refund offset was expanded in 1984 to other federal non-tax debts, such as unpaid student or small business loans. Because of concern that collection of non-tax debt could affect compliance with the tax laws, Congress directed the Treasury to study the impact of these offsets on future compliance. The long-term effect is the subject of a five year study that we are now conducting. We expect to publish interim results later this year and final results in 1994. The study will also estimate the costs of the program, including any increase in the cost of collecting tax debts. It will also estimate revenue lost as a result of subsequent taxpayer noncompliance.

The refund offset program has been successful in securing payments on past due federal debts. In 1991, IRS offset over 1.5 million refunds and secured over $900 million for all federal agencies. Of that amount, over $360 million is for defaulted student loans and has been remitted to the Department of Education.

Taking into account all of these factors, Congress and the Administration must ultimately make the policy decision whether IRS should become the collection agent for all federal debts. Let me explain. Under the IDEA proposal, Congress would move from requiring IRS to act as a debt collector of _last_ resort to establishing IRS as the _primary_ federal debt collector for student loans. Under the current rules, IRS is only required to offset any tax refund due an individual who is delinquent in paying a non-tax federal debt. Under the IDEA proposal, IRS would collect the entire loan repayment. Under IDEA, this would be a federal obligation, but not a tax. Under Mr. Miller's proposal, this repayment would, in fact, be a tax. While IDEA speaks only to collecting student loans, it seems likely that this concept, once begun, would eventually be extended to other non-tax federal debts. To date, no cost-benefit analyses have been done to determine whether there is an overall savings to the government from transferring collection responsibilities to IRS. These analyses, along with research on the potential impact of such a proposal on the tax system, must be done before Congress and the Administration can make an informed decision on how to best collect all monies due the federal government. IRS will continue to work with the Department of Education on costs analyses of the various proposals.

Above and beyond the policy decision of whether IRS should become the government collector for all federal debts, we have some very practical concerns about the feasibility of such a proposal. Based on our preliminary analysis of the IDEA and similar proposals, such an idea could be implemented only with a lead time of at least five years. These reservations stem from an analysis of the impact of the IDEA proposal on 1) the ability of taxpayers and employers to cope with the changes, 2) the current tax processing system limitations, 3) our revenue accounting system, and, 4) our tax collection activities. Moreover, we currently have neither the computer capacity nor the resources to undertake such an effort.

III. IMPACT ON IRS PROCESSING AND ACCOUNTING SYSTEMS

The IDEA proposal would have a significant impact on the Service's current processing systems. We have not done extensive estimates of the computer capacity needed to implement this program nor have we projected costs. However, we believe that implementing the provisions would require substantial forms and processing changes, increased capacity, new accounting routines and greatly increased Collection enforcement resources.

Congressman Petri's office estimated that between 1 and 1.8 million borrowers would take advantage of the IDEA program the first year. Eventually, over 12 million accounts could be active on the system. Every one of those accounts would need some type of maintenance by the Treasury, even if it is just to calculate that no repayment is due that year. The processing changes would impact the processing of the over 100 million individual income tax returns since our routines must take into account all possible forms and schedules.

The discussion of this proposal must also take into account the work now being done on Tax Systems Modernization (TSM). Former Commissioner Goldberg and other IRS executives testified last year before both Houses of Congress about the need to modernize our tax system. We are at a crossroads at the IRS. Outmoded systems make it difficult for us to properly store, timely deliver or update information already in our system. If the IRS is to be charged with the collection of nontax debts, we would need to begin planning for this as part of Tax Systems Modernization.

In analyzing the proposal, we have assumed that maintenance of the loan account would be handled by an agency other than the

IRS, although under HR 2336 the Secretary of the Treasury could assign that responsibility to the IRS. Assuming that IRS' role is primarily to collect repayments, we would have two major responsibilities: 1) we would transmit to the lending agency tax return information that would enable them to calculate the amount due from the borrower/taxpayer in the coming year; 2) we would collect payment information from the tax return and transmit that information to the lender to apply to the outstanding loan(s). Computations related to the loan would be done outside of the tax system by the lending agency. Once the computation is made, however, IRS systems would need to keep track of the amounts paid and to generate balance due accounts if the loan repayment is less than the expected amount calculated.

To implement this legislation, the Form 1040 would have to be revised to calculate loan repayment amounts due and to record loan payments transmitted. We are assuming that we would design an IDEA repayment schedule that would be attached to the 1040. Adding a new line and schedule to the 1040 is much easier said than done. In addition to changing the form and instructions, we would need to re-write software, design new processing routines in the service centers, train staff in the service centers and Taxpayer Services sites, account for money collected with the returns, and inform and advise taxpayers about completing the return. The impact on these activities would be significant.

The IRS would have to adapt several systems to process IDEA accounts. First, to accommodate those loan accounts that are not paid in full, we would have to examine our entire account structure which now includes 155 million individual tax accounts. IDEA accounts would have significant differences from tax accounts, so we could not maintain them as tax accounts in the Individual Master File as it is currently designed. Among the differences are the length of time the accounts would be maintained and the different interest calculations that would apply. Tax accounts are generally kept in active files for only a few years; although unpaid tax accounts are kept for 10 years; a delinquent IDEA account could be active for twenty-five years or longer. We have not estimated the exact impact of these accounts because we do not know exactly what information we would capture for each account.

Likewise, processing loan payments that are not delinquent could cause some problems. As we contemplate processing changes for 1993 and beyond, we are confronting very real limits to our ability to capture information from the Form 1040. Modifying the computer record that is built from the Form 1040 to transmit information to the Individual Master File to accommodate loan payment information would require format changes. These changes would create unacceptable overhead and severely impact processing times. We have a major effort under way to address this problem based on current needs.

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The IDEA bill would require the IRS to send notices to borrowers with outstanding IDEA loans in January of every year. The actual production of such a notice that would show that the borrower is in a repayment status, the maximum account balance, the current account balance and the method of computation used to determine the amount due would not be difficult. However, there would be a tremendous impact on Taxpayer Service sites and service centers which would have to respond to inquiries on these notices each year during our busiest season. In addition to up-front costs for printing, sorting and mailing, we would need resources to respond to these taxpayer inquiries. Our experience is that whenever we send a notice, even one that just conveys information to the taxpayer, we will receive inquiries to our call sites and service centers, in this case asking about incorrect loan balances, for explanations of repayment computations.

IV. IMPACT ON COLLECTION ACTIVITIES

In addition to the processing issues, which are significant, the primary additional workload would be incurred in our Collection function. At the beginning of the Collection process, we would need to make clear to taxpayers whether we are collecting delinquent taxes or student loan repayments. We anticipate having to use two types of notices or to show the amounts separately on each notice. We may need to maintain two separate systems in order to compute account balances or to answer taxpayer questions on their accounts. If we needed to make personal contact to collect the tax, we must be able to tell taxpayers whether we are collecting a student loan or a tax delinquency. All IRS programs could be affected by this new workload.

The collection of delinquent student loan payments would add to the very sizeable existing accounts receivable inventory. A portion of this inventory is made up of current accounts which we will collect in due course. However, about 27% of the inventory is composed of cases which we categorize as currently-not-collectible. These cases include bankrupt taxpayers, taxpayers who cannot pay because of hardship and taxpayers that we cannot locate. While under IDEA provisions many of these taxpayers would be exempt from making repayments, we believe that many of the delinquent student loans which cannot be collected through the offset program will fall into this category. It is likely that the offset program operates at a much lower cost than would the more comprehensive program envisioned by IDEA.

We have a major effort underway to improve our handling of accounts receivable which has been the subject of numerous hearings before Congress over the last two years. We appointed a high level executive to serve as Accounts Receivable Executive Officer. This executive is responsible for coordinating the many different aspects and IRS functions that must work together to reduce the rate of growth in accounts receivable, particularly in uncollectible accounts.

We are concerned that we could not devote sufficient collection resources to delinquent student loan liabilities. Because our current collection workload exceeds the resources available to work it, balance due cases are ranked in priority order for future work, primarily on the amount due. Cases ready to be worked are held in a "queue" that assigns cases based on their priority as staff to work them becomes available. Based on a review of the payment amounts in the charts accompanying Mr. Petri's bill, we conclude that many of the delinquent student loan cases would not be assigned a high enough priority under our current rating system and therefore would receive only routine attention. Although those cases would receive delinquent notices (4 to 5 notices) and could result in levy action, they most likely would not be worked by Revenue Officers making personal contact.

Nonfiler case workload would also be affected. This work is also prioritized based on potential tax due and available resources. We would have to determine whether to treat potential loan payments as we would potential delinquent taxes when determining which non-filer cases to pursue.

A major assumption of the proposals is that the IRS would be an effective collector of delinquent loan payments. Because of the unique nature of tax obligations, the Service is given wide ranging authority to take distraint action to effect collection of delinquent taxes. This authority, or even the threat of using it, is a primary reason that the IRS collected over $24 billion from delinquent accounts last year. Congress recognized the importance of our ability to enforce collection administratively, and has recently given similar authority, administrative wage garnishment, to the Department of Education. Administrative wage garnishment, similar to our levy authority, should greatly increase the collection of delinquent student loans.

V. IMPACT ON TAXPAYERS AND EMPLOYERS

The bill envisions that the student's loan payments would be paid along with an individual's current year's tax. However, it does not seem to anticipate altering the withholding tables and estimated tax worksheets to ensure that taxpayers pay in the amounts that would be due for student loans. In fact, borrowers will not know their liabilities until January of the year the payment is due (on April 15th).

The IRS takes very seriously its role in educating taxpayers about the best way to meet their tax obligations. In order to avoid a large number of taxpayers discovering that they owe a significant amount and must pay it within a short time, the Form W-4 (Employee's Withholding Allowance Certificate) would have to be revised to factor loan repayments into the withholding calculation. Although this would further complicate the Form W-4, which already contains a page of additional worksheets for taxpayers with two jobs or for two wage-earner households, we believe it would be necessary to avoid balance due tax returns. While borrowers could compute their anticipated repayment amounts when they complete their education, they would need to adjust the repayment if their income changed.

These revisions would need to be communicated to taxpayers, employers, and practitioners at least a year before the repayments were due to give taxpayers the maximum amount of time over which to spread their payment. Instructions to employers are particularly important since they field most questions from employees about their withholding.

VI. LEAD TIME AND RESOURCE NEEDS

We must note that the bill does not have specific effective dates nor do they contemplate a transition period. We would need significant coordination with the Department of Education to arrange the transition and to develop protocols for ongoing information needs. Education, for example, is responsible for determining the eligibility of an institution to participate in the loan program. We would also have to coordinate systems modification efforts with the agency designated to make the loans.

We have not estimated either the cost of modifying our systems or the operational costs once implemented. Significant coordination also would be necessary to develop common assumptions that would enable all IRS functions to accurately estimate the time and resources necessary to implement this bill. From our preliminary analysis, start-up costs would be significant, and we note that neither bill contains funding for start-up but only for administration of the loans. If the IRS were to also take on the responsibility for developing a loan processing program, which we are not experienced in administering, lead time and resource needs would increase significantly.

VII. CONCLUSION

Mr. Chairman, I do not want to convey the impression that the IRS would not be able to collect student loan repayments if that is the will of the Congress and the President. However, I must emphasize that this would be a major change in the way we do business and would impact many different aspects of our tax administration system -- a system that we are committed to improving through simplification and through our modernization efforts over the next decade.

We know that, with proper planning, we can implement major tax legislation. We have done so in the past and we expect to make major changes in the very near future. However, as Former Commissioner and now Assistant Secretary of the Treasury for Tax Policy Goldberg frequently noted, in order for us to implement tax law changes, we must consider all aspects of the changes on our system. As I noted at the beginning of my statement, we will continue to work with the Department of Education to pursue these issues in greater detail in a variety of scenarios.

We appreciate your taking this opportunity to determine what the impact on the IRS would be as you consider this legislation.

Mr. Helm and I will be pleased to answer any questions you or the Members may have.

Mr. **Miller.** Thank you very much for your testimony. I don't know that I have a lot of questions because I think the issues that you quite correctly raised will not be necessarily addressed by this committee. But I think you certainly raised a number of those issues.

In the preparation of your testimony, has the IRS looked at this system or is this sitting down in terms of preparing for this morning and thinking about the kinds of issues that would be raised? Have you done any formal studies on what major debt collection would mean or not mean to the IRS?

Mr. **Bigelow.** Well we have been looking at this bill ever since we became aware of it and have been working with the Department of Education. There was some discussion about calculating our cost, how much it was going to actually cost to implement this type of a thing within our own administration of it. But beyond that, I'm not sure how extensive because, you know, we do have that one 5-year test already undergoing, looking at noncompliance, which is a big concern we have.

Mr. **Miller.** So, there is some additional sort of fleshing out of the proposal that can be done if hearings are held in either Finance or Ways and Means with respect to what you believe the cost or the manpower requirements and so forth are?

Mr. **Bigelow.** Absolutely, and our staffs would be more than willing to work with staffs of this committee or of those other committees on anything that we would need to flesh out.

Mr. **Miller.** I've learned not to tread too deeply into the other committees' jurisdiction, so I think I've had my last question. But I do appreciate very much the willingness of IRS to come and to discuss this, because, obviously, the implementation of this would be terribly, terribly important in terms of the expectations that we will create and hopefully the reality that we will create about the accessibility of this program.

I think that these questions go to transition times, it does go to questions of whether some of this can be folded into the other study that you have ongoing to try to develop this information. But again, those are questions better raised by staff and members that fully understand the complexities of the IRS system. I only try to comply, nothing beyond that.

Mr. Petri?

Mr. **Petri.** Thank you. I'd like to compliment you and your staff for the time that you have put in, in working with my staff and with others on attempting to understand where we're coming from and helping us to understand how the IRS operates with many of your internal procedures and policies. I think that process is moving forward.

We'll give students enormous assistance if this does go into effect. But it's something that must be administratively sensible and sensitive to the requirements and constraints that you face in doing your business.

I do have a few questions, and you may not be able to answer all of them, which is understandable. But there's a difference, I think, and I just don't understand the reason for it, in your characterization of Mr. Bradley and Mr. Miller's bill in your prepared statement on page 5 as a tax, and the IDEA collection as a non-tax government debt.

Is that because of something in the way our bill is drafted? Mechanically, it seems to be the same thing. They're both taking percentages of income, and we think it can fairly be characterized as a tax in both cases. But I'd like to hear your explanation for why one is characterized as a tax and the other is not.

Mr. BIGELOW. I think the way we envision it is that the one speaks of it directly, where, in your bill it does not. That's the characteristics of the two. I think if you want to declare it as a tax, you need to—you know, I would recommend it be more clear.

Mr. PETRI. That might be helpful if you're worrying about this policy of suddenly getting into the business of collecting everything. Since this is income related, we could argue that it's on the tax side of the divide rather than on the government obligation side.

Mr. BIGELOW. That's true.

Mr. PETRI. Those obligations are not income-sensitive, normally.

Mr. BIGELOW. One thing we always watch for is the ability for the taxpayers to understand the tax system, the education that we try and put out there. Student loan collection would require a major effort in order to convince, I think, the public this is really a tax. So, it's those kind of perceptions we'd have to work on in order to educate—if we just put it into the tax. But it would still have some major differences from the normal tax, as I pointed out, interest computation——

Mr. PETRI. Carryover from year to year and so on. I just have three other questions briefly. If you assume that an agency such as the Financial Management Service actually maintains the IDEA accounts, and that your job at IRS is simply to report payments to the FMS and collect delinquent payments, isn't that similar to what you already do in collecting self-employment social security taxes and reporting them to the Social Security Administration?

Mr. BIGELOW. I'm saying it's not insurmountable. They just require different accounting routines. We would have to have separate lead times in order to develop those accounting routines, depending on which side of the—if it's just a trust fund as opposed to just go into the national treasury, those types of things.

It could be worked out, and that's why I want to make sure that you don't think that we're totally against it. We don't have a real position on it, but things could be worked out. It's in the accounting functions.

Mr. PETRI. This is a slightly mischievous question so you may not want to answer it, but on the question of lead times, and your estimate that it might take 5 years to phase this program in, there are a lot of different tax and IRS-based proposals floating around town these days. It seems to be that time of year.

Does your testimony mean basically that it might take 5 years to put in place the proposal for a new credit for first-time home buyers or a new type of reverse IRA account, or is that somehow less onerous than this particular new proposal?

Mr. BIGELOW. As far as the 5 years, you know, I don't know if it would be 5 years, number one. First of all, what you have to look at is any time tax legislation is passed, we always try and work with the staff to give adequate lead time. It depends on if you're changing simply the percent of tax due. That's a very easy computer routine in order to change.

If you're changing the entire accounting systems for the accountability of those funds, which is something that is in this bill, or the interest computation routines, we struggle with that under our antiquated systems. It requires a lot more lead time.

So, it really depends on the actual legislation, and we try to work very closely with all the different areas of Congress passing this to make sure that they understand that. We've had very, very good cooperation, I think, in giving us adequate lead time that we would need. It really just depends on how complex. This is a lot more complex than most of the ones that are going on now.

Mr. PETRI. Just one last question. The adoption of IDEA would eventually get the IRS completely out of the business of refund offsets for student loans. Aside from the question of volume, that is if you were doing it for the same number of taxpayers each year, would you rather withhold refunds from student loan defaulters who may really be hardship cases, or collect IDEA taxes that are guaranteed to be a reasonable percentage of income, and that people would actually have the ability to pay?

Mr. BIGELOW. I think that's a policy decision as opposed to an administration decision. All we do is administer the tax laws. So, I would not want to get into that one.

Mr. PETRI. Thank you.

Mr. MILLER. Mr. Sawyer?

[No response.]

Mr. MILLER. Mr. Andrews?

Mr. ANDREWS. Thank you, Mr. Chairman. Mr. Bigelow, thank you for your remarks. They were very well thought out, and we appreciate them. Do you think that there's a reasonable analogy between the ideas Mr. Petri has been talking about and the payroll deduction for U.S. savings bonds that an employer withholds?

Mr. BIGELOW. I've never really given it any thought between the two.

Mr. ANDREWS. My experience has been that, generally speaking, probably hundreds of thousands of employers across the country have a voluntary payroll deduction for U.S. Savings Bonds. It's an asset, single asset. It's the bond issued by the United States government. This would be a loan issued by the United States government.

The point that I'm making, isn't the direct lending component of Mr. Petri's bill a tool of simplification for IRS collection, since, in fact, the U.S. government owns the asset that's the basis of the collection? The person has to give their social security number, their address, their other information at the time they make the loan. Doesn't that substantially simplify the problems that you outlined in your testimony?

Mr. BIGELOW. In the collection aspect? Mr. Helm?

Mr. HELM. Yes. I also hadn't really focused on that aspect of it. One of the concerns that we have in Collection is that a portion of our accounts receivable inventory, a significant portion, is made up of what we call trust fund liabilities; that is the employees withheld taxes and FICA. This, of course, would add to the employer's burden, if you will, not only in terms of withholding but in depositing those taxes on a regular time schedule.

So, whatever order of magnitude the annual payment would add to that employer's burden, the potential of the Internal Revenue Service, encountering delinquency on the part of the employers in collecting that tax, is an issue. We haven't quantified that at all, of course, because we're at such early stages in considering the impact on the Service.

Mr. ANDREWS. Would you agree, though, with the statement that the switch to a loan program where the United States government is the owner of the note, is the payee under the note, simplifies the collection problem, from your point of view?

Mr. HELM. Again, I'm not sure I have a point of view on that. On the surface, it sounds like that. But again, I personally haven't thought about that aspect of it.

Mr. ANDREWS. Thank you.

Mr. MILLER. What's the easiest way to do this for the IRS?

Mr. BIGELOW. As far as what?

Mr. MILLER. To guarantee this collection and to provide for this collection?

Mr. BIGELOW. Well, we have found that the refund offset program is not very expensive to run. It certainly brings in a lot of money. We still have some concerns as far as how many taxpayers do not subsequently file as a result of having this happen to them once, and that's part of that study. But as far as administrating this program—you know, we offset for 26 agencies right now.

As you can see, it's big bucks. It's very easy for us. We have those routines already developed. Even if we change this one, we would still maintain those for all those other government agencies and government debts.

Mr. MILLER. I see. Any other questions by any members?

[No response.]

Mr. MILLER. Thank you very much. I'm sure we'll continue to be in touch with you as this progresses. Thank you.

Mr. BIGELOW. Thank you.

Mr. MILLER. Next we will hear from a panel made up of Mr. J. Shawn Landres, who is a student at Columbia University; Ms. Stacey Leyton is Vice President of the United States Student Association; Mr. Arthur Hauptman, who is an education consultant; Mr. Kenneth Sears, who is Associate Director of Financial Aid, West Virginia University Health Sciences Center; and Mr. Jerry Davis, Vice President of Research and Policy Analysis of Pennsylvania Higher Education Assistance Agency.

Welcome to the committee. Again, your prepared statements will be put in the record in their entirety. We will recognize you in the order in which I called your name, and look forward to your testimony.

STATEMENTS OF J. SHAWN LANDRES, STUDENT, COLUMBIA UNIVERSITY, NEW YORK, NEW YORK; STACEY LEYTON, VICE PRESIDENT, UNITED STATES STUDENT ASSOCIATION, WASHINGTON, DC; ARTHUR HAUPTMAN, EDUCATION CONSULTANT, WASHINGTON, DC; KENNETH SEARS, ASSOCIATE DIRECTOR OF FINANCIAL AID, WEST VIRGINIA UNIVERSITY HEALTH SCIENCES CENTER, MORGANTOWN, WEST VIRGINIA; AND JERRY DAVIS, VICE PRESIDENT, RESEARCH AND POLICY ANALYSIS, PENNSYLVANIA HIGHER EDUCATION ASSISTANCE AGENCY, HARRISBURG, PENNSYLVANIA

Mr. LANDRES. Thank you very much, Mr. Chairman. My name is Shawn Landres. I'm a sophomore at Columbia University. I'm the government affairs representative on the Columbia College Student Council.

I come to you today from a university which, because of the cutbacks in Federal and State aid over the past 10 years, is grappling with a tough problem. It looks like that next year, for the first time in over 20 years, Columbia will no longer have need-blind admissions, and it will no longer have full coverage of financial need.

That would be a tragedy for Columbia, and it would be a tragedy for students from every State who have the opportunity to get a great education, because they had a commitment that no matter what their needs were, if they had the stuff to go to Columbia, they were going to get through.

Today, we're looking at two bills, H.R. 2336 and H.R. 3050, which would obviate the need to move away from need-blind admissions and to move away from full coverage because every student who needed to borrow money, who wanted to borrow money would be able to, and they would know that they would be able to pay back that money at a reasonable percentage of their income.

Now, I've spoken to a number of students at Columbia. I've talked to them about IDEA. I've talked to them about SRS, and this is their feeling. We like IDEA a lot better because we like the higher loan limits. We like the method of repayment because you don't have to start paying back your loans until you actually make something that the IRS is going to make you pay taxes on, and because the system is very sensitive to student needs and to budgetary realities.

I've also brought up the point with students that under IDEA or under SRS, they would be paying more interest payments, and they would be paying their loans for a longer period of time. But what they say to me is, "Am I going to default on my loans?" I say no.

I say you're going to be paying a reasonable percentage of your income. They tell me that that's a reasonable bet. They'd rather pay a little more a little longer, or maybe a lot longer, and not default on their loans and not have their credit ratings ruined.

They don't know whether they're going to have jobs next year at Columbia. They don't know what their future holds. I know that the members here have talked about this in caucuses all over the place about a whole host of issues, but this program makes a commitment to students. It's budget sensitive; it's not budget neutral.

But as students and as voters and as taxpayers, we know that education doesn't exist in a vacuum, that in an ideal world we would have a Pell Grant entitlement, and I think we should have a Pell Grant entitlement. But if it doesn't happen this year, we'd better make sure that there is something a lot better than we had going into this reauthorization process.

I think that IDEA is a step toward that. I think that we can do a lot to make sure that students get into school, they get into the schools that they want to go to and they can go to. I was reading the New York Newsday on my way down here. Twenty-eight percent of students this year chose their school because of low tuition or because of financial aid. That's up 5 percent, up from 23 percent of students just last year choosing for low tuition, up from 25 percent of students choosing for good financial aid offers.

Everyone should be able to go to the school where they want to, where the program that they want to study is the best, not where they have the money to go. It doesn't make sense. So, that's why we're supporting IDEA. That's why we believe that an income-contingent loan system would make a lot of sense.

I have a lot of details in my testimony that I would love to take questions on. I have concerns about some things in SRS with the average annual postgraduate income, for example, that would sort of determine minimum and maximum payments. As we've seen in this recession, those numbers are very different in New York, Los Angeles, Atlanta, Chicago. There's no real national average that I think is fair to operate on.

I think that there are plenty of issues that are worth going into. But the bottom line is this: access is down, retention is down. We have a budget deficit in this country, but we have more than that for the students of my generation. We have an education deficit, and what's even worse is we have a hope deficit.

So, when you consider these bills, I hope that you will look to the future of my generation and say what can we do to make America stronger, to make our future brighter, to make us more competitive on the international scene, and to make it possible for our generation to continue to live the American dream. Thank you.

[The prepared statement of J. Shawn Landres follows:]

Testimony of

J. Shawn Landres

Government Affairs Representative,
Columbia College Student Council
Chair, Student Higher Education Advocacy Committee,
Columbia University

before the
Committee on Education and Labor,
United States House of Representatives

regarding
HR2336, the "Income-Dependent
Education Assistance Act of 1991"
and
HR3050, the "Self-Reliance
Scholarship Act of 1991"

2175 Rayburn House Office Building
Washington, D.C.

February 6, 1992

Mr. Chairman, distinguished members of the Committee:

My name is Shawn Landres. I am a sophomore at Columbia University in the City of New York, and my family lives in Santa Monica, California. I serve as Government Affairs Representative for the Columbia College Student Council, and I chair the Columbia University Student Higher Education Advocacy Committee. This past spring, I coordinated the Columbia College Student Council's Washington Student Delegation, and had the opportunity to speak with many of you regarding our concerns about the Higher Education Act. I am pleased to submit my comments regarding HR2336, the "Income-Dependent Education Assistance Act of 1991," and HR3050, the "Self-Reliance Scholarship Act of 1991."

Mr. Chairman, thank you for making students an integral part of the reauthorization process. I hope that we have been able to contribute constructively to the reforms which we all know need to take place. My thanks are due also to Congressman Thomas Petri, whose continued dedication to the question of a workable income-contingent loan is to be commended.

Before us today are two bills, both of which contain provisions which would replace the current income-contingent loan program within the Higher Education Act. While each bill attempts to address fundamental problems in the pilot project — high interest rates, the prospect of a lifetime of unsubsidized payments for low-income graduates, and fixed payments in the first two post-graduate years — I believe that HR2336, the Income-Dependent Education Assistance Act, provides for a fairer and more effective loan program. Realistic loan limits, a highly efficient repayment system, and an equitable cross-subsidy combine within IDEA in a way which is sensitive both to student needs and to federal budget realities.

Because it would be a supplemental program, rather than a replacement for other student loans, IDEA would allow students greater freedom to choose among different postsecondary financing options. However, those students who wished to consolidate their loans and to manage them more easily would be able to convert all of their GSLs into IDEA loans.

A more refined income-contingent loan program would greatly expand access for students of all income levels and would dramatically broaden the choices available to your constituents, whose postsecondary education options are ever more restricted by financial — rather than educational — considerations. At a financial aid forum I helped organize last year, one student described the conflict she felt between her desire to become a teacher and her need to repay her student loans. Her sentiments are echoed time and again across campuses all over America: "I'd really like to go into community service, but I have to pay back my student loans, so I guess I'll become a lawyer."

Income-contingent loans will allow thousands of graduates to balance student loan payments with the austerity of the community servant's annual compensation. Although loan deferment and forgiveness programs do exist under certain limited circumstances, they do not allow the flexibility needed. Only an effective ICL can cap loan repayments at a reasonable percentage of income.

Based upon my conversations with Columbia students of all socioeconomic backgrounds, I am confident that an income-contingent loan program would attract a high number of participants. Among those with whom I talked were students who would not otherwise borrow, because of concerns about high fixed payments. They indicated that they would be likely to take advantage of a loan program in which their payments were a manageable percentage of their income. Additionally, a considerable number of students who are Stafford, PLUS, and SLS borrowers said that they would much prefer an ICL's more reasonable interest rates and more favorable repayment schedule. Most importantly, however, many students who currently do not qualify for federal aid — and who anticipate high post-graduate incomes — showed great interest in the program. These are precisely the borrowers ICLs require to balance their budgets.

I believe that the implementation provisions found in HR2336 are superior to those in HR3050 for three major reasons:

The loan limits in HR2336 are more realistic. HR3050's complex system of determining repayment schedules reduces its effective limit well below the already tight $33,000 cap. IDEA's limits, at $70,000 for most students and higher for medical students, much more effectively address current and future student need. Furthermore, studies have revealed that the more postsecondary education a student receives, the higher his or her postgraduate income will be. Those students whose lending approaches the cap are more likely to have the high postgraduate income needed to help power the program. The bottom line: it is possible to finance a college education and even some graduate school using only the IDEA program; the same is not necessarily true for the SRS plan.

IDEA's repayment system efficiently and fairly addresses concerns about IRS implementation. Under IDEA, only those borrowers whose income reaches or exceeds the tax filing threshold would be required to submit payment. In contrast, HR3050's repayment calculus is problematic for two reasons: first, it uses Census estimates of the national average post-graduate income to determine what minimum and maximum payments should be. However, post-graduate incomes differ greatly from region to region, because of differences in the cost of living, and more importantly, because of differences in the economy. Second, and more importantly, the minimum payment requirement in HR3050 would generate huge amounts of paperwork at IRS, as all borrowers — even those whose incomes fall under the normal tax filing threshold — would be required to submit minimum payments and documentation. This minimum payment requirement would unfairly burden low-income and unemployed students — precisely those students whom ICLs usually assist the most. Such a payment would be especially onerous during recessions, when few graduates are able to find steady work.

The cross-subsidy within the IDEA program keeps it self-contained and inherently equitable. From an economic standpoint, it makes sense to charge high-income graduates slightly more and to subsidize the payments of low-income graduates: in this way, no one is required to forfeit an unreasonable percentage of his or her income to student loan repayments. Philosophically, as well, it creates a situation wherein students are — through the cross-subsidy — helping each other to succeed.

Some of IDEA's critics have expressed concern about skyrocketing costs. One concept which HR3050 includes, and HR2336 does not, and perhaps should include, is that of a national postsecondary education trust fund, an idea most recently advocated by Arkansas Governor Bill Clinton. Such a trust fund provides an easily measurable indicator of the success or failure of an income-contingent loan program. If loan disbursements and subsidies exceed repayments, the fund runs a deficit; if, as we anticipate, after a number of years, repayments begin to overtake disbursements and subsidies, the fund can be considered a success.[1]

To be sure, setting up an education trust fund would require a great deal of financial support. The economist Robert Shapiro, in his excellent paper, *Paying for Progress*, estimates that cutting back on certain subsidies to high-income people "could release $15 to $20 billion or more to help young Americans prepare for the future."[2] That number coincides with Deputy Secretary Kearns' worst-case assumption that IDEA loans could reach $20 billion annually.[3]

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[1] Without any revenue-enhancing measures, an education trust fund might require fewer than fifteen years to become self-sustaining. Catholic University economist John J. Murphy has estimated that if the federal government were to borrow $20 billion per year at 9 percent interest, an education loan fund would be self-sufficient after only fourteen years.

"He has assumed that 4 million students drew an average of $5,000 a year, that repayment began after four years, and that the students' average income in the fifth year was $20,000 and increased by 5 percent annually thereafter. With these figures as given, as repayment rate of 9 percent of gross income would pay off the obligation in twenty years. A repayment rate of 5 percent of gross income would require thirty-five years to satisfy the obligation.

"If, to establish the fund, the government borrowed, at 9-percent interest, the money needed to support $20 billion in annual advances (i.e., using the assumptions on levels of participation and advances given above), the fund would become self-sustaining after fourteen years; if the government paid no interest on the money it advanced, the self-sustaining point would be reached after eleven years. (These figures assume a payback based on 9 percent of the beneficiary's gross income.) Multiply $20 billion by the eleven or fourteen years and you have a cumulative total of grand proportions. But you also have a solution to a mammoth national problem." William J. Byron, S.J., "Neither Grant Nor Loan: New Ground for Federal Student Aid Policy" in Lawrence E. Gladieux, ed., *Radical Reform or Incremental Change: Student Loan Policy Alternatives for the Federal Government* (Washington: The College Board, 1989) 30-31.

[2] "The Treasury could raise $5 billion a year by taxing 85 percent of the benefits of retirees with joint incomes of $32,000 and above; however, we also would increase the income threshold, and so raise less. Various medicare proposals could raise $2 to $8 billion; capping the state-and-local-tax deduction at 9 percent of a person's adjusted gross income would raise $6 billion. For discussion, see Congressional Budget Office, *Reducing the Deficit: Spending and Revenue Options*, February 1990." Robert J. Shapiro, *Paying for Progress: A Progressive Strategy for Fiscal Discipline* (Washington: Progressive Policy Institute, 1991) 6.

[3] "With the significant expansion of loan eligibility and loan limits included in the bill, annual borrowing could approach $20 billion." *Testimony By David Kearns, Deputy Secretary for Education, before the Senate Committee on Labor And Human Resources, on the Financial Aid for All Students Act of 1991, Tuesday, October 29, 1991*, 6.

We must remember who would be paying the interest on any increased government borrowing — we, the students. If IDEA were unable to pay for itself, requiring an infusion of federal funds, we, the current and future taxpayers, would still be the ones paying for our education. However, we would not be making those payments during the particularly trying early postgraduate years, when many students find it difficult to meet their living expenses because they are not earning enough to pay their loans and still put dinner on the table. For students, IDEA is virtually a win-win opportunity.

Most important to me in this entire process is the philosophy embodied in the income-contingent loan: giving back to the community. Through income-contingent loans, society gives the gift of education and the student, financially and through his or her career and service to the community, repays that obligation. It is simple, fair, and effective.

Mr. Chairman, I would be happy to respond to any questions you or any other member of the Committee might wish to ask me.

Ms. LEYTON. Mr. Chairman and members of the committee, thank you for this opportunity to testify on H.R. 2336 and H.R. 3050. My name is Stacey Leyton, and I'm vice president of the United States Student Association, representing more than 3.5 million postsecondary students in 4-year public and private institutions, technical schools, and community colleges.

As you know, USSA is a strong supporter of H.R. 3553, which would go a long way toward our shared goal of equal educational opportunity. We particularly applaud the inclusion of the Pell Grant entitlement, which we believe is a necessary prerequisite for making our loan programs work in the interest of students.

Let me emphasize that USSA is a strong supporter of the concept of direct lending of student loans by institutions. My written testimony details the reasons for our position as well as our views on how a direct lending system should be executed. Let me also emphasize that USSA sees the issue of direct lending as very separate from H.R. 2336 and H.R. 3050's provisions for income-contingent loan repayment through the IRS.

Basically, USSA appreciates the intent of Representatives Petri and Miller to help students and their families afford a postsecondary education and to lessen the impact of postgraduation debt burdens. However, USSA is concerned about some aspects of these two bills, including student loan collection through the IRS, 25-year repayment periods, and the lack of an in-school interest subsidy.

We thus have some thoughts on how income-sensitive loan repayment as an option could be used in the interest of students. USSA agrees with Mr. Petri and Mr. Miller that income-sensitive loan repayment is an idea well worth considering.

That is why we are supportive of a number of provisions in H.R. 3553 which would ease the loan burden from students, including provisions to provide graduated repayment schedules for Stafford Loan borrowers who request it, require that students be notified by both the seller and the purchaser when their loan is sold, and mandate that graduated or income-sensitive repayment schedules be offered to consolidation loan borrowers.

H.R. 2336 and H.R. 3050 further extend these income contingent loan ideas. We have the following concerns regarding H.R. 2336. First, without significant increases in funding for the Pell Grant program, H.R. 2336 would exacerbate the loan grant imbalance particularly among dependent students who would see the amounts they could borrow nearly double.

However, independent students currently eligible for Stafford and SLS Loans would see a dramatic decline in the loan amounts they can borrow because the bill would eliminate the SLS program, and Stafford Loans would count against the total IDEA Loan limits.

Second, under H.R. 2336, the interest rate on IDEA would float up to 10 percent and have no in-school interest subsidy. This would make IDEA Loans much more onerous for needy students, even though they would have no origination fees and insurance premiums. In fact, Mr. Petri's own statistical analysis indicates that many students would see an increase in their total student loan indebtedness after graduation if they chose IDEA Loans over Stafford Loans.

Students in long-term programs and graduate school would generate particularly huge IDEA Loans. For example, a typical student who takes out an unsubsidized SLS Loan of $4,000 will, after 9 years, have had to repay $8,362. You can imagine what that loan would look like under a 25-year repayment plan. Hence, if students must borrow to finance their postsecondary education, the loans they take out should only be Perkins and Stafford Loans, which have subsidized interest rates and an in-school interest subsidy.

In order to correct the problem of negative amortization, that is when low payments mean that students keep paying off the interest but never touch the principal, H.R. 2336 proposes forgiving IDEA Loans after 25 years. The indisputable bottom line is that if you were on a 25-year loan repayment plan, you end up paying much more than if you were on a standard 10-year plan. Under such a prolonged repayment period, borrowers would still be paying off their loans while in their 40s and 50s and while many are trying to purchase homes and raise families.

In any event, USSA believes that it must be a conscious choice for students to commit themselves to such a prolonged repayment period that means ultimately that they owe a huge amount to the Federal Government and end up repaying quite a lot of money. In addition, in order to avoid a Federal subsidy, H.R. 2336 requires one group of student borrowers to subsidize another group of student borrowers. This is an inappropriate and unfair way to subsidize low-income borrowers.

Third, H.R. 2336 may complicate, not simplify, the student loan repayment process. We have the following concerns regarding IRS loan collection. Where are students supposed to turn for counseling and information on their student loan repayment options and problems, the IRS? The current system is far from perfect, but at least students can work with their lender on deferment options.

Will the IRS or the Department of Education provide counseling? What if a student is drawing a salary and having increased employer withholding for their student loan repayment but has genuine hardships? How can students predict what their monthly loan payments will be? After graduation, a student's earnings are probably the most unpredictable aspect of his or her life.

Isn't IDEA a disincentive to working? If you never work and file taxes, you will never have to repay your loans? While USSA understands the economic conditions and structural barriers that make it difficult to find employment in this country, we fear that political and public support for a program with a perceived built-in disincentive to work would eventually be undermined.

In terms of H.R. 3050, borrowers could choose among 15-, 20-, or 25-year repayment options. The exact impact of these different options for borrowers is not clear to us. In addition, under H.R. 3050, a minimum level of repayment is set so a borrower could not avoid repaying their loan even if they are unemployed. While this avoids the problem of a disincentive to work, it could impose real hardships for students, many of whom, in today's tough economic times, are finding it difficult to obtain steady and well-paying jobs. We do appreciate the fact that the Self-Reliance Scholarships would supplement and not replace current loan programs.

One last concern is that both these bills would provide quite an incentive for institutions to raise tuition. Schools could continue raising tuition, which would be matched dollar for dollar by increased loans for students. Pell Grants, however, would not increase dollar for dollar as tuitions rise.

As an alternative to these proposals, USSA joins the American Council on Education in proposing an optional income-contingent loan repayment plan for borrowers whose income is inadequate to service their debt for a period of years. We believe that these borrowers should have the option to petition the government to allow them to repay on an income-contingent basis during the period in which their salaries are inadequate to service their debt without great hardship. Interest during this period that is not taken care of by the borrower's payments should be forgiven and not added to their total debt.

For most borrowers, this period of lower payments would probably be temporary. But for those who are still repaying their loans after a certain period of time, 25 years or so, should have their remaining debt forgiven. We believe that this kind of income-contingent proposal is feasible, necessary, and much more in the interest of students. Under these other proposals, USSA is concerned that students would simply fall into 25-year loan repayment plans without a conscious choice to do so and without an understanding of all of the consequences.

Many students do not get all the necessary information when they first receive and/or start repaying their loans. For many, taking out a loan is the very first financial decision in their lives. Students should not choose at the outset of receiving their loans a 25-year repayment period simply because they are anxious about their future income potential after college. In any event, an optional postgraduation income-contingent repayment process would be the student's choice and not something into which he or she falls and later regrets.

Lastly, USSA has some philosophical problems with the premises behind these two bills that propose to create new loan programs to address the very real problems of declining access to higher education, skyrocketing college costs, and difficult student loan burdens. New loan programs will not sufficiently address the underlying reason why students default on their student loans.

Half of Stafford Loan defaulters are dropouts from postsecondary programs. We should not assume that all of these students choose not to pay back their loans; we should recognize that most of them simply cannot pay them back.

While USSA shares the concern about the increasing costs of Stafford Loan defaults, we believe that better loan collection through the IRS is not the answer. What is desperately needed is an increased commitment to retention programs and grant programs including a Pell Grant entitlement.

In conclusion, USSA urges this committee to carefully consider how any income-contingent loan program system would work and whether our shared goals of increased access, enhanced information, and loan repayment rates, and simplification of the student loan system would be achieved.

Thank you for this opportunity to share USSA's thoughts on this legislation.

[The prepared statement of Stacey Leyton follows:]

USSA 'Organizing and Advocating for Students Across the Country'

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February 6, 1992

STATEMENT OF THE UNITED STATES STUDENT ASSOCIATION ON H.R. 2336 AND H.R. 3050

Before the House Subcommittee on Postsecondary Education

Stacey Leyton
Vice President
United States Student Association

Mr. Chairman and Members of the Committee, thank you for this opportunity to testify on **H.R. 2336 ("The Income-Dependent Education Assistance Act")** and **H.R. 3050 ("The Self-Reliance Scholarship Act")**, and the possibilities of income-contingent repayment of federal student loans. My name is Stacey Leyton and I am Vice President of the United States Student Association (USSA), the largest and oldest national student organization, representing more than 3.5 million postsecondary students in four-year public and private institutions, technical schools and community colleges.

As you already know, USSA is a strong supporter of H.R. 3553 ("The Higher Education Act Amendments of 1991"), which would go a long way toward our shared goal of equal educational opportunity. We particularly applaud the inclusion of the Pell Grant entitlement, which we believe is a necessary prerequisite for making higher education accessible to all.

Basically, the USSA Board of Directors appreciates the intent of Representative Petri and Representative Miller to help students and their families afford a postsecondary education, and to lessen the impact of post-graduation debt burdens. However, USSA is concerned about some aspects of these two bills, including student loan collection through the Internal Revenue Service; 25-year repayment periods; and elimination of the in-school interest subsidy. We thus have some thoughts on how income-sensitive loan repayment as an option could be used in the interests of students.

Let me emphasize that USSA is a strong supporter of the concept of the direct lending of student loans by institutions. While we have many concerns regarding how a direct lending system would be phased-in and executed, we are very supportive of the concept because of the enormous savings and enhanced simplicity of such a system. This testimony will also detail these concerns. Let me finally emphasize that **USSA sees the issue of direct lending as very separate from H.R. 2336 and H.R. 3050's provisions for income-contingent loan repayment through the IRS**.

Lastly, USSA recognizes that the student loan programs have enabled countless students to pursue a postsecondary education. However, our recommendations for the student loan programs and repayment options are accompanied by our strong belief that a Pell Grant entitlement is a necessary prerequisite to making our loan programs work in the interests of students.

INCOME-CONTINGENT LOAN REPAYMENT

USSA agrees with Mr. Petri and Mr. Miller that income-sensitive loan repayment is an idea well worth considering. It is true that students are graduating with huge and often onerous loan burdens: in 1986, students graduated from public institutions with an average debt of $6,810 and from private schools with an average of $10,000 worth of debt. That is why we are supportive of a number of provisions in H.R. 3553 ("Higher Education Act Amendments of 1991"), which would ease the loan burden from students, including provisions to:

- Provide graduated repayment schedules for Stafford Loan borrowers who request it [Section 424 (a)];
- Requires that students be notified by both the seller and the purchaser when their loan is sold [Section 427 (i)];
- Mandate that graduated or income-sensitive repayment schedules be offered to consolidation loan borrowers [Section 430 (f)].

H.R. 2336 and H.R. 3050 both involve income-contingent loan repayment through the Internal Revenue Service, and the direct lending of loans through institutions. Both create unsubsidized loans, and H.R. 2336 eliminates the Supplemental Loans for Students program (for independent students). Under H.R. 2336 but not under H.R. 3050, loans under the new program (i.e. IDEA) would count against Stafford Loan limits (and vice versa). In an attempt to make the loan repayment process more manageable for students and to decrease the number of student loan defaults, students would pay their loans (under the two new programs) on an income-contingent basis through increased payroll-tax withholding.

H.R. 2336, "The Income-Dependent Educational Assistance Act"

While USSA does support the idea of income-sensitive methods of loan repayment, we would be concerned about H.R. 2336's construction of income-dependent loan assistance for the following reasons.

		Annual Loan Limits		
	Current		H.R. 2336	
	Stafford	SLS	IDEA Credit	Difference
			(Stafford loans would count against annual\ aggregate IDEA loan limits, & SLS would be eliminated.)	
Undergraduate				
1st & 2nd Year Dependent Students*	$2,625		$6,500	$3,975
" Independent Students	$2,625	$4,000	$6,500	- $125
Other Dependent Undergraduates*	$4,000		$8,000	$4,000
" Independent Undergraduates	$4,000	$4,000	$8,000	0
Graduate/Professional**	$7,500	$4,000	$11,000	- $500

* The PLUS loan program for parents of dependent students would continue under H.R. 2336.

** Under H.R. 2336, medical and other high-cost doctoral degree students would be eligible for up to $22,500 of IDEA credit. Students in extraordinarily high-cost graduate degree programs would be eligible for up to $30,000.

(1) Without significant increases in funding for the Pell Grant program, H.R. 2336 could exacerbate the loan/grant imbalance, particularly among dependent students. H.R. 2336 would continue the Stafford Loan program, create an unsubsidized loan program (IDEA), and eliminated the Supplemental Loans for Students (SLS).

Currently, only independent students (and in rare circumstances, some dependent students) are eligible for the unsubsidized SLS program. Under H.R. 2336, any loans received under Title IV of the Higher Education Act (as well as Title VII of the Public Health Service Act) must be counted against the annual and aggregate IDEA loan limits, and IDEA loans must be counted against the annual and aggregate loan limits of these other loan programs.

The result is that for students not eligible for SLS (i.e. dependent student), H.R. 2336 practically doubles the maximum loan limits! While USSA supports inflation-adjusted increases in the maximum loan limits - this is a little extreme!! The key to expanded access is NOT larger loan burdens, but significant increases in the grant programs, including a larger maximum Pell Grant (and to add some certainty - and fact, rather than fiction - to the Pell Grant program, it needs to be an entitlement!).

However, independent (and other) students currently eligible for Stafford and SLS loans would see a dramatic decline in the loan amounts they can borrow (between $125 and $1,300) - which USSA finds objectionable in light on skyrocketing college costs. How can we ask independent and graduate students - large numbers of whom are mostly older, have children and other dependents to support, and have no family to turn to for resources - to make do with less?

(2) Under H.R. 2336, the interest rate on IDEA would float (T-bill plus 2 percentage points, not to exceed 10%) and have no in-school interest subsidy; this would make IDEA loans much more onerous for needy students. IDEA loans would also have no origination fees and insurance premiums. USSA is not convinced that these factors "cancel each other out." In fact, Mr. Petri's own statistical analysis indicate that many students would see an increase in their total student loan indebtedness after graduation if they chose IDEA loans over Stafford loans. Students in long-term programs and graduate school would generate particularly huge IDEA loans. We believe that it is the responsibility and in the self-interest of the federal government to offer student loans with manageable terms and that will have the least impact possible on the job and career choices of graduates. Hence if students must borrow to finance their postsecondary education, the loans they take out should only be Perkins and Stafford Loans, which have subsidized interest rates and an in-school interest subsidy.

We only have to look at the current SLS program to see the adverse affects of a loan program lacking an in-school interest subsidy. Looking at an actual Repayment Addendum and Disclosure Statement from a lender to a SLS borrower, a student from Louisiana, shows that after she makes repayments on her SLS loan of $4,000 over the next nine years, she will have had to repay $8,362. She will have to pay $8,362 for a $4,000 loan. It's crazy that poor people are expected to pay twice as much for their education!

Now, H.R. 2336 attempts to address the problem under the current Income Contingent Loan program of students forever paying off their loans because of negative amortization - that is, students whose low-paying jobs result in their paying off the interest but never touching the principal, and remaining indebted for life - by forgiving their IDEA loan after 25 years of repayment. 25 years is a long time to keep penalizing students, and is hardly a reward for taking out an ever-growing loan. The indisputable bottom line is that if you are on a 25-year loan repayment plan, you end up paying much more than if you were on the standard 10-year plan. Under such a prolonged repayment period, borrowers would still be paying off their loans while in their 40's and 50's, and when many are trying to purchase homes and raise families. In any event, USSA believes that it must be a conscious choice for students to commit themselves to such a prolonged repayment period that means ultimately that they owe a huge amount to the federal government and end up repaying quite a lot of money.

In addition, in order to avoid a federal subsidy, H.R. 2336 requires one group of student borrowers to subsidize another group of student borrowers. Higher-income borrowers would pay at a higher interest rate than they do under the SLS program. IDEA's interest rate would be T-bill plus 2%, capped at 10%. However, if a student's post-graduation income was sufficiently high to repay the loan in 12 years or less, an "early repayment" penalty would be charged. At the same time borrowers with such low-paying employment that they do not file taxes would not have to make student loan payments. If a borrower is still paying after 25 years, the rest of her/his loan would be forgiven.

(3) H.R. 2336 may complicate, not simplify, the student loan repayment process. While USSA strongly supports the idea of income-sensitive loan repayments as a more fair and manageable way for students to repay their loans, we have concerns about H.R. 2336's particular way of collecting income-dependent loan repayments.

- Where are students supposed to turn to for counseling and information on their student loan repayment options and problems? The IRS? The current system is far from perfect, but at least students can work with their lender on deferment and forbearance options. Will the IRS or the Department of Education provide counseling? What if a student is drawing a salary and having increased employer withholding for their student loan repayment, but has genuine hardships?

- How can students predict what their monthly loan payments will be? After graduation, a student's earnings are probably the most unpredictable aspect of his/her life! Won't employers have increased administrative expenses as participants in loan collections? Will they and the IRS get administrative cost allowances?

- Isn't IDEA a disincentive to working? If you never work and file taxes, you will never have to repay your loans? While USSA understands the economic conditions and structural barriers that make it difficult to find employment in this country, we fear that political and public support for a program with a perceived built-in disincentive to work would eventually be undermined.

H.R. 3050, "The Self-Reliance Scholarship Act"

Our concerns about H.R. 3050 are very similar to those we have regarding H.R. 2336. H.R. 3050 would allow students to borrow up to $10,000 with a maximum of $33,000. Borrowers could choose among 15, 20 or 25 year repayment options. The exact impact of these different options for borrowers is not clear to us. In addition, under H.R. 3050 a minimum level of repayment is set so a borrower could not avoid repaying their loan even if they are unemployed. While this avoids the problem of a disincentive to work, it could impose real hardships for students, many of whom - in today's tough economic times - are finding it difficult to obtain steady and well-paying jobs. We do appreciate the fact that the Self-Reliance Scholarships would supplement and not replace current loan programs.

One last concern is that both these bills would provide quite an incentive for institutions to raise tuition. Schools could continue raising tuition, which would be matched dollar-for-dollar by increased loans for students (to a high level because both would, overall, increase maximum loan limits). Pell Grants, however, would not increase dollar-for-dollar as tuitions rise.

Income-Contingent Loan Repayment for Students with Economic Hardship

USSA agrees with the proposal advanced by the American Council on Education on income-contingent loan repayment for borrowers whose income is inadequate to service their debt for a period of years (i.e. those who debt service exceeds 10% of their income). This group includes students who choose a career in low-paying public interest fields, as well as those who did not persist in higher education and do not have significantly higher incomes. We join ACE in believing that these borrowers should have the option to petition the government to allow them to repay on an income-contingent basis during the period in which their salaries are inadequate to service their debt without great hardship. Interest during this period that is not taken care of by the borrowers' payments should be forgiven and not added to their total debt. For most borrowers, this period of lower payments would probably be temporary, but for those who are still repaying their loan after a certain period of time (25 years or so) should have their remaining debt forgiving.

We believe that this kind of optional income-contingent loan repayment takes care of many of our concerns regarding most income-contingent proposals. Students would not just automatically be put on the 25-year loan repayment track: since they would have to petition for such a payment plan, they would be fully cognizant of the implications of income-sensitive repayment (i.e. it could extend the number of years they would be paying off their loans).

We believe that this kind of income-contingent proposal is both feasible, necessary, and much more in the interests of students. Under these other proposals, USSA is concerned that students would simply fall into 25-year loan repayment plans without a conscious choice to do so and without an understanding of all the consequences. Many students do not get all the necessary information when they first receive and/or start repaying their loans. For many, taking out a loan is the very first financial decision in their lives. Students should not choose at the outset of receiving their loans a 25-year repayment period simply because they are anxious about their future income potential after college. In any event, an optional post-graduation income-contingent repayment process would be the student's choice, and not something into which he or she falls and later regrets.

Also, at this time, we are still uncomfortable about the Internal Revenue Service playing any role in student loan collection.

Lastly, USSA has some philosophical problems with the premises behind these two bills that proposes to create new loan programs to address the very real problems of declining access to higher education, skyrocketing college costs, and difficult student loan burdens. New loan programs will not sufficiently address the underlying reason why students default on their student loans. We should not assume that all of these students choose not to pay back their loans; we should recognize that most of them simply can't pay them back. While USSA shares the concern about the increasing costs of Stafford Loan defaults, we believe that better loan collection through the Internal Revenue Service is not the answer. What is desperately needed is an increased commitment to retention programs and grant programs, including a Pell Grant entitlement.

There are many reasons why students default, including ones for which it is unfair to assign blame to the student. Half of Stafford Loan defaulters are dropouts from postsecondary programs. These people are not likely to have the job prospects or enhanced earning power that accompany a postsecondary degree or certificate, and thus face difficulty repaying their loans. **Many student loan defaulters WANT to pay back their loans; they just CANNOT.** Hence, we must strengthen our investment in the retention programs - including the TRIO Programs for Students from Disadvantaged Backgrounds - that enable students to stay in school. We must make Pell Grants an entitlement ... which would decrease the amount of low-income students forced to take on huge loans to pay for their postsecondary education and increase their persistence rates. We must also ensure that students have all the knowledge necessary to make good decisions and to be responsible and informed student loan borrowers - and H.R. 3553 would definitely help in this area. Without these changes, better loan collection techniques through the IRS will not help improve the number of students paying back their loans.

DIRECT LENDING

The second major element of these two bills are their use of federal borrowing as the source of loan capital for student loans. At USSA's 44th Annual National Student

Congress held in August 1991, students from all over the country voted to support the concept of the direct lending of student loans by institutions. We applaud the inclusion of direct lending in H.R. 3553 for the following reasons:

- Simplification of the loan application, delivery, updating, and repayment processes ... and reduction of loan defaults. The current GSL structure of more than 13,000 lenders, over 50 guarantee agencies, and many secondary markets results in an overwhelming system of multiple application forms, fees, paperwork and massive confusion for too many students. By contrast, the Perkins Loan program is far easier for students to understand and use. USSA believes that many defaults are the result of the complexity and confusion of this system that leaves too many students with too little information and no sense of who to go to for answers.

- Increased efficiency. Because of the complicated nature of the system, students experience numerous delays in getting their loans, causing much hardship: students are penalized for paying their tuition bills late or are dropped from their classes, and have difficulty paying their child care costs or putting food on the table. Under a direct loan program - like the Perkins Loan program - a school could process and deliver a loan along with a student's regular financial aid application. In addition to reducing paperwork, the school would have direct control over the timing and distribution of loan funds. Hence, students would receive their loans more promptly.

- The possible elimination of origination fees and insurance premiums.

- The possibility of substantial savings (a reduced need to pay the special allowance rate) that could be channeled into increased grant aid. Estimates of savings range from $600 million to $1.4 billion.

- Automatic loan consolidation.

- Reduction in defaults/better counseling. If schools originate the loans along with the regular financial aid application, students would get more and immediate information on how and when to repay their loans, and deferment and consolidation options. In addition, a Harvard study found that a direct loan program would reduce or simplify 44% of its administrative functions associated with the current Stafford Loan program. A decrease in the administrative complexity for institutions would mean that schools could devote more of their energies on reducing defaults through better counseling of student loan borrowers.

However, USSA hopes that the following questions will be satisfactorily answered as the full House discusses and considers direct lending:

- Will there be adequate capital so that the loan program will remain an entitlement under which every student who is eligible for the program can get a loan?

- Will there be a phase-in period so that there is opportunity to assess and address problems in the system?

- How do we prevent institutions from "red-lining" students they consider risky borrowers? Since institutions are being held responsible for high default rates (i.e. high default schools are being cut off from participation in student loan programs), will they deny loans to students whom they think are likely to drop out and default? Will this end up denying first-generation college students, and students from low-income and ethnic minority backgrounds access to loans and a postsecondary education?

- If financial aid offices at direct lending institutions take on new overhead costs and thus require additional funding, will there be new costs passed on to students? Would direct lending really eliminate the need for origination fees and insurance premiums? If there are savings from restructuring the loan program, will they go to student aid programs? Or will all savings be lost to new administrative costs for the Department of Education and institutions?

- Will nontraditional students - older students, part-time students, and evening students - receive adequate services regarding loans if financial offices are only open during the day?

USSA looks forward to further discussing these issues as you consider direct lending proposals, and stands ready to be of assistance. **We think that the direct lending could be a powerful way to ensure that student loans work in students' interests.**

In conclusion, USSA urges this Committee to carefully consider how any income-contingent loan program, and/or direct lending system would work and whether our shared goals of increased access, enhanced information and loan repayment rates, and simplification of the student loan system would be achieved. Thank you for this opportunity to share USSA's thoughts on this legislation.

Mr. HAUPTMAN. Thank you, Mr. Chairman. There's a chart in the back of my testimony which compares the features of the number of the different loan proposals, and that might be helpful if you wanted to keep track of that.

My testimony indicates that at least four distinct issues are raised in the current set of loan proposals. First is a question of direct lending, whether it would be more efficient to use the government as a source of loan capital rather than the private sector, as in the current GSL programs.

Second is whether the Federal Government should continue to pay the in-school interest for borrowers while they remain in school.

Third is whether the amount of loan repaid should be geared to the income of the borrowers once they are in repayment, so-called income-contingent repayments.

Fourth is whether the IRS should be responsible for loan collection.

As today's testimonies, I think, demonstrate, those issues tend to get mixed up. You can start a discussion with direct lending, and then you're into income contingent, and then we're talking about IRS collection. People say I'm for this or I'm against that. It would be very helpful as the debate evolves for people to try to be careful and say which is it that they're talking about, which do they want.

You can have a direct loan program with or without the in-school interest subsidy. You can have a direct loan program with or without income-contingent repayments. Conversely, you could have an income-contingent repayment system imposed or layered on to the current GSL program with no direct loans. So, as you go through it, I think that would be helpful for all concerned.

Today I wanted to talk briefly about direct lending and then turn my attention to what might be done in the repayment period to help reduce defaults. The current situation of the Stafford Loan Program speaks volumes about the inappropriateness of the current financing arrangement in the Stafford Loan Program. The 91-day Treasury bill rate is currently below 4 percent.

Since the rate returned to lenders in the Stafford program is paid at the T-bill rate plus 3.25 percentage points, that rate of return would be roughly 7.25 or less at the current time. But the rate charged to borrowers and the rate that the government pays lenders during the in-school period is set by statute at 8 percent; thus, banks, Sallie Mae and other holders of student loans are currently receiving in excess of the statutory rate of T-bill plus 3.25.

As a result of this loophole, Sallie Mae's profits and its price, I expect, will go up quite a bit. Banks and other holders of student loans will also find their profits increased during this time. At a minimum, I hope the committee, during reauthorization, will consider closing this loophole so the government would only have to pay the lesser of T-bill plus 3.25 or a percent, rather than the greater of the two, which is what happens now.

This current situation also suggests the possible desirability to shift to a variable interest rate in Stafford just as what was done in the last reauthorization for the PLUS and SLS programs. It's worth knowing that borrowers in the SLS program who do not have financial need now pay a lower interest rate than Stafford borrowers who are determined by financial need.

This current excess in payment to lenders also points out the potential cost savings of direct loans. Rather than have the government pay out T-bill plus 3.25, direct loans achieve savings by having the government pay, in effect, the T-bill rate. That's how it is at current T-bill rates where they are low. When T-bill rates get higher, let's say 10 percent, then there's no saving on the in-school interest subsidy. The saving occurs in the fact that you eliminate the special allowance.

So, now, savings of direct loans would be reducing the amount of money the government pays the banks during the in-school period. In the higher T-bill rate situation, the savings would be under the special allowance, elimination of special allowance.

I know a lot of people who oppose the direct loan concept, argue that additional administrative costs would outweigh these savings. I find that statement difficult to believe and largely unsubstantiated. You could have administrative costs of twice or three times the level of current program and you'd still have substantial savings in the program.

My testimony also points out why I believe the administration's arguments against direct loans are largely specious. For example, the administration opposes direct loans because it will require the Federal Government to borrow to provide the loan capital. But in the current Stafford program, the government, since it is already in deficit, is borrowing over $5 billion a year to pay for annual interest in default costs. At least under direct loans, most of what is borrowed will be repaid, unlike the current program which, whatever the government borrows to make those payments, is never repaid.

The bottom line is I would argue for an adequately-funded and representative direct lending option that allows for a demonstration of whether direct loans will save taxpayer dollars over the next 5 years. The GSL program should not be totally cashed out in that period of time and replaced with an untried idea, but neither should we stick exclusively with a current model when there is another approach that could potentially save Federal taxpayers billions of dollars with no decrease in access.

I also would comment that it is necessary, I think, to have a good demonstration to try several different administrative procedures in making those loans. I mean, we might all agree that the concept is worthwhile, but we have to test out a couple different administrative procedures. I hope we don't make the same mistake as we did with the ICL program that the Reagan Administration proposed where there was only one model that was in effect, and, therefore, we never got to test anything.

In terms of reducing default costs, we have to look more at the terms and conditions that borrowers face and the system repayment than at loan origination, which is what direct loans is all about. The problem I have with most of the proposals currently on the table that would revamp repayment is that they start with the assumption that the system should be self-financing.

The practical fact is that to achieve self-sufficiency, it's necessary to do one or several fairly unpleasant things: first, remove the in-school interest subsidy; second, require that borrowers with high incomes after graduating subsidize their less fortunate colleagues, the cross-subsidy issue; and/or third, require that unpaid interest is added to the principal owed by low-income borrowers whose income-contingent repayments are not sufficient to pay the interest that they own on their loans. In other words, if you owed $800 of interest and your income-contingent payment is only $600, that $200 of interest would be added in the case of negative amortization. On the matter of in-school interest, I pointed out in my testimony that none of the other proposed changes are likely to save anywhere near the money that would be saved if there were no Federal in-school interest subsidies. As a result, the proposals that do call for deferral on accrual of interest during the in-school period, such as Petri or Miller/Bradley, do achieve much higher levels of cost savings than the proposals that do not.

In terms of cross subsidy, I believe it would be far preferable for the Federal Government to subsidize those students who need help with their repayment than to require cross subsidization or to require all borrowers to pay on an income-contingent basis.

With all deference, Mr. Chairman, I think it's going to be difficult to make the case that Miller/Bradley, for example, is a good program for middle class students if you're going to ask those middle class students, many of them, to repay on their loans more than what they borrowed in interest and principal.

So, what I would like much more to see is a case where the people who can make repayments on a regular amortized basis continue to do so, and we focus income contingency and graduated repayment on a set of students who really need the help; that is, those whose debts exceeds their income or whose debt service exceeds a reasonable portion of their income to repay. I think it would be much more administratively feasible, and I think it would be a lot easier to sell.

There's a chart in my testimony behind page 6 which shows the different proposals as it relates to this cross subsidy. There's a horizontal line on it which is basically equal amortized payments. Those plans that have lines above those horizontal lines, that's essentially the size, the degree of the cross subsidy. Those higher income bars, those bars with incomes roughly above $35,000 are going to be paying back more than what they owe on a regular basis. Those bars with incomes below $35,000 are essentially the ones that we're trying to subsidize.

The Simon bill manages to avoid cross subsidy by basically saying once you have paid back the amount of interest and principal you owe, that's enough. That's one way of doing it.

My own personal preference would be for a flexible repayment approach in which borrowers whose debt exceeds their income can petition for relief while all other borrowers continue to repay, as they do now, on an amortized basis. One way of doing that is laid out in the Association's statement for today's hearing.

The basic point is that income contingency is not for everybody. For the majority of borrowers who are promptly repaying their student loans, it is neither desirable nor necessary to make them repay on an income-contingent basis. Such a repayment schedule should be confined to those borrowers who need the assistance.

I also want to emphasize the importance of allowing flexible repayment for students who are already in the system, as well as providing it for whatever new loans may be made. If flexible repayment or any other income-contingent scheme is restricted only to new borrowers, all current borrowers are condemned to not having any alternative means of repayment if their income is less than their debt.

The more than $50 billion of loans currently in repayment will spin out at an annual default cost of $3 billion or so per year for the next 5 or 10 years if no repayment options are offered to borrowers already in the pipeline. I think the Petri bill is the best on this regard because they allow current GSL borrowers to come into the new system. So, any proposal that does that I would myself support.

In terms of negative amortization, Simon, Miller/Bradley, and Petri all would require that interest be added to principal when income-contingency payments exceed a borrower's interest obligation. The committee bill, by contrast, does not require negative amortization. For that reason, I would favor it, at least for that proposal.

Finally, on the matter of IRS involvement, I want to point out that involving the IRS in student loan collection does not reduce defaults to zero. If a student does not have enough income to repay their student loans, having the IRS on their case is not going to resolve the issue any differently. The IRS cannot affect the repayment of borrowers who are unable to pay rather than those who are unwilling to pay.

Through the rough sense of the magnitudes involved here, roughly one-third of the loans that default now are repaid under the arrangement by which State guarantee agencies collect on those loans after default has occurred. When you take out the 30 percent that the agencies retain, that brings it down to about 25 percent—of the loans that default, about 25 percent of them, net, are repaid over some period of time.

There was recently, as part of the Unemployment Insurance Compensation Bill, a provision for wage garnishment. The Department of Education apparently assumes that wage garnishment would increase this collection to roughly 50 percent or possibly a little bit more. It would be my guess that IRS collection might raise this collection figure to maybe 70 or 80 percent, but that still leaves 20 to 30 percent of defaults uncollected. In short, the IRS collection reduces the default problem but does not make it go away.

I just want to add one thing which is I've heard a number of folks at different times state that tuitions would be fueled by these—an increase in tuitions would occur as a result of these provisions.

I don't see anything in the bills that either leads to higher tuitions or lower tuitions than what we have today in the current student aid system. I've talked about that to this committee before and would be glad to answer questions about it. But I'm reluctant to have the argument made that this is going to lead to runaway tuition increases in the future.

Thank you, Mr. Chairman. I'd be glad to answer questions at any time.

[The prepared statement of Arthur Hauptman follows:]

ANALYSIS OF ALTERNATIVE LOAN PROPOSALS

Testimony of Arthur M. Hauptman
before the House Education and Labor Committee
Subcommittee on Postsecondary Education

November 14, 1991

Mr Chairman and Members of the Subcommittee:

I appreciate the opportunity to testify before you today on several of the proposals currently before the Congress which would entail reforms in the federal student loan programs. Specifically you have asked me to review the strengths and weaknesses of H.R. 2336 and H.R. 3050. To place these bills in context, however, I will also refer to current law and to other proposals that are before the Congress, including the House Committee bill itself (H.R. 3553).

I want to begin by urging you to recognize that the various pieces of legislation which Congress is now considering contain at least four provisions that would substantially modify the current system of student loans, including:

- **Direct Lending by Institutions;**
- **Elimination of the In-School Interest Subsidy;**
- **Income Contingent Repayment Schedules; and**
- **Loan Collection by the Internal Revenue Service.**

Each of these four issues deals with very different aspects of the current loan system. Direct lending is a question of the source of capital for student loans. The provision of the in-school interest subsidy involves who should receive government benefits. Income contingency is a repayment issue. IRS involvement raises the question of program administration.

Each of these issues is controversial in its own right and deserves serious conversation. The public policy debate, in my view, is not enhanced when these issues are all lumped together and debated collectively. Each should be dealt with separately, argued on its own merits. To this end, I have included at the end of this testimony a chart which compares the various provisions of these bills in an effort to highlight both their similarities and differences at least with respect to these four issues.

Direct Lending. The notion behind the various direct student loan proposals is a simple one: that it would be cheaper for the federal government to finance student loans by borrowing at the Treasury bill rate than to rely on the current program in which banks and other private sources of capital are paid 3.25 percentage points above the prevailing Treasury bill rate to make the loans. In addition, a direct loan arrangement could ease program administration by enabling educational institutions to package all aid at the campus level rather than send students to banks for their loans.

Curiously enough, the debate over direct loans first gathered steam over a year ago when newspaper accounts indicated that the Bush administration was considering a proposal to replace the existing bank-based program with direct loans. Since then, however, the Administration has apparently decided that it would rather stick with the existing student loan program and its $5 billion a year price tag than try something new.

Not surprisingly, banks and others that profit from the program are now lauding the Administration against those in Congress who want to try a direct loan approach. They have generated analyses which assert there are many hidden costs to direct loans and have produced reams of rhetoric explaining why it would be better to stay with the existing program than to take a chance on the unknown.

Ironically, after years of claiming that they only make student loans out of a sense of social obligation, the banks are now saying they would like to continue making student loans because it is one of their few remaining profitable lines of business. A recent study released by the Department of Education bears this out: it indicates that student loan profit margins are higher than for many other types of bank investments, including car loans, home mortgages, and Treasury securities.

What has been surprising is that administration officials in the Department of Education and at OMB are mouthing the same concerns as the banks. In response to this Subcommittee's request for the Administration's view on direct loans, Education Secretary Lamar Alexander first gave lukewarm support for the concept of direct lending but expressed concerns about the particulars of the proposal that is being debated. More recently, the Secretary has said that the President would likely veto a bill that contained direct lending provisions.

The Administration has three basic objections. First, it says that the federal government should not be borrowing money to make direct loans, thereby increasing the debt and the deficit and possibly creating another S & L-type bailout in student loans. Second, it is reluctant to create a program that would obligate the federal government to bear all the risk of default, unlike the current program where it claims some risk sharing now exists. Finally, the Administration opposes direct loans because it says that its own Department of Education is not competent to run such a large undertaking.

The Administration's three blind mice of no more federal borrowing, no risk sharing, and no competence deserve to be put to sleep. On the matter of federal borrowing, Administration officials for some reason are choosing to ignore the fact that under the new credit reform rules which they advocated and which were adopted as part of the 1990 budget agreement, direct loans were placed on an equal footing with guaranteed loans under federal budget accounting procedures precisely as a way to make federal loan programs more efficient. The Administration's opposition to direct student loans also ignores the fact that since the federal budget is in deficit, the federal government borrows more than $5 billion a year for interest and default payments in the current program which it never will get back. At least under direct loans, much of whatever the government borrows will be repaid.

Despite OMB assertions to the contrary, there is no real risk sharing in the current program. As long as lenders follow "due diligence" rules, they are assured of receiving 100 percent of whatever default claims they submit to the state-designated agencies that initially guarantee the loans. Borrowers are charged fees to cover whatever the federal government does not reimburse the state agencies. Moreover, last year when the the biggest such agency, the Higher Education Assistance Foundation (HEAF) failed, the federal government picked up the pieces by fully guaranteeing the remainder of HEAF's bad loans.

The fact is that risk sharing in both Stafford Loans and direct loans could be easily achieved by having participating lenders and colleges eat a portion the costs of defaults over a certain level, and by not allowing them to shift these costs to borrowers. The Administration surely would do better by considering reasonable alternatives instead of its apparent current policy of simply rejecting out of hand anything to do with direct lending.

The question of the competence of the Department of Education to administer a program of this size is a valid one, especially if direct loans were run as a highly centralized program. But a direct loan program could and should be highly decentralized, with many of the administrative responsibilities farmed out to the state agencies or other nonprofit groups at a fraction of the cost of what the government currently pays the banks.

What is needed in this debate now is less rhetoric and more thoughtfulness about how a direct loan program might actually work. The critics of direct loans are right when they say that it is neither feasible nor desirable at this time to cash out the existing program and to replace it with an untried idea where few of the details have been worked out. But it makes even less sense to say that since this idea of potentially great benefit is untested, we should blindly stick with the inefficient and very costly model we now have.

The more reasonable alternative would be to establish a substantial direct lending option now of at least several billion dollars a year. Then over a period of several years, direct lending could be responsibly evaluated and compared to the existing program. By the time of the next reauthorization in 1997 and probably even sooner, we would then have a much better sense whether direct loans is the right answer for the future or not.

It is also critical that the direct lending option be set up to allow for adequate evaluation and testing. In this context, care should be taken to avoid many of the pitfalls that befell the Income Contingent Loan program that was included in the 1986 reauthorization. The ICL pilot was flawed in several fundamental ways that doomed its effectiveness from the first. Participating institutions were allowed little or no flexibility in designing how they would provide the loans. The ICL loan terms were distinctly less favorable to students than the regular GSL program and the percentage of income that borrowers were required to repay in many cases would disqualify the borrower from being eligible for a mortgage. Not surprisingly, the vast majority of students chose GSL over ICL. In addition, the ICL pilot was inadequately funded, with only 10 schools participating, certainly not enough to give a true perspective of the merits of the approach. In short, the ICL was not designed to allow for an adequate evaluation, a major shortcoming for a program billed as a pilot.

A direct lending option in this reauthorization should consciously avoid the mistakes made with ICL. The option should be large enough to allow for adequate testing of different approaches. Institutions which participate should be allowed sufficient latitude in trying different kinds of direct lending approaches. The terms and conditions to student borrowers should be the same as in the GSL program to provide a level playing field. One possibility would be to test direct lending in several designated states, and to allow state agencies to act as direct lenders for students at nonparticipating institutions.

You should also note that none of the alternatives now being discussed by the Congress are as radical as the suggestions made by Bob Reischauer or Barry Bluestone. Their proposals would involve using the Social Security Trust Fund as a future source of student loan capital and the payroll tax system as the means of repayment. Personally, I find the notion of using the Social Security system as a source of capital quite appealing, although I would advocate lending the funds to the institutions rather than directly to the students. I would also note that the Reischauer/Bluestone approach would be substantially less amenable to an experimental pilot program than the direct loan approaches presently under consideration in the Congress.

Elimination of the In-School Interest Subsidy. The largest long term subsidy in the current GSL program, it may surprise you, is not defaults. Instead, it is the interest the federal government pays on behalf of borrowers while they are in school and for a grace period thereafter. In-school interest costs comprise well over half of the total long term federal costs of loans, when costs are measured over the life of the loan and discounted to reflect their present value as called for under credit reform rules.

The House Committee bill would preserve this subsidy, but each of the other proposals discussed here would eliminate it. In place of the federal payment of interest, the other proposals would allow students to defer their interest obligations while in school and to add this interest to the principal amount borrowed.

The potential for federal cost savings are a major reason for eliminating the in-school interest subsidy. *All of the other provisions combined in the various proposals now before Congress -- including direct lending, income contingent repayment, and IRS collection -- do not generate as much federal cost saving as the elimination of the in-school interest subsidy.* The other principal argument for eliminating the in-school interest subsidy is that it may be more appropriate to provide subsidies in this program based on the income of the borrower during repayment than to subsidize borrowers on the basis of their parents' or their own income before they borrow. I find this a very compelling argument, but it only works if income contingent repayment options are provided *and* if some range of low income borrowers are subsidized during repayment.

The principal argument for retaining the in-school interest subsidy is that its elimination will greatly add to the loan burden of borrowers. The individual who borrows $10,000 while an undergraduate could easily end up owing $15,000 due to the accrual of interest while in school. The medical student with $100,000 initially borrowed ends up with $150,000 or more in principal and interest owed. Rather than correcting the "loan/grant imbalance", the elimination of the in-school interest subsidy would add to it.

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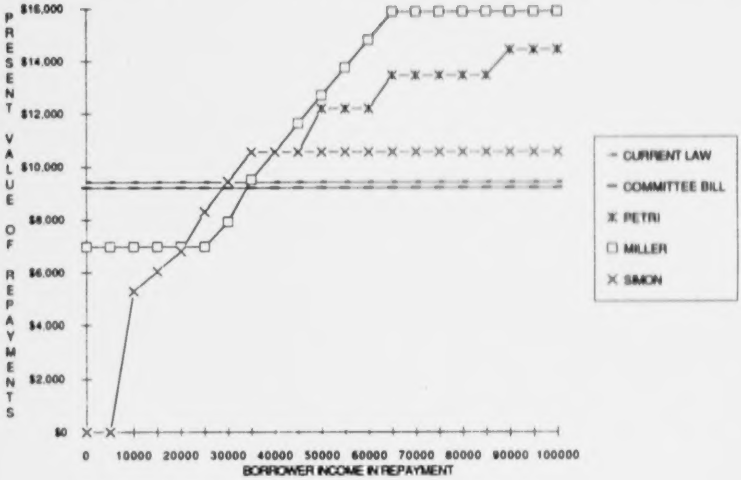
Ultimately, the question of whether to retain the in-school interest subsidy should boil down to the relative merits of different subsidies. The attention that is being paid now to various student loan proposals has had the ancillary positive effect of highlighting the fact that the federal payment of in-school interest is of substantial value to the borrower. For many middle class students, their exemption from paying in-school interest far exceeds the value of their becoming eligible for Pell Grants. My advice is that Members should think hard about the relative merits of grants and in-school interest subsidies rather than viewing them as entirely different forms of assistance.

Income Contingent Repayment. The concept of income contingent repayments for student loans has been around for a long time, stretching back at least to an article written by Milton Friedman in 1945. The basic notion is that it makes more sense for student loan borrowers to repay on the basis of their income once they complete their education than to charge them a fixed amortized amount that often bears little resemblance to their ability to repay.

In the context of the current debate, several key questions should be raised with regard to income contingent repayments. One is the formula for determining the level of repayments. The second is whether all borrowers should be subject to income contingency, or should it be restricted to those borrowers who cannot meet their repayment obligations. And third is what happens to those borrowers whose income contingent repayments are insufficient even to repay the interest on their loan obligations.

Income contingent repayment can be tied to a number of factors, including: the interest rate charged, length of repayment, and the percentage of income that is devoted to student loan repayment. Most income contingent proposals in the past have called for a fixed percentage of income per $1000 borrowed. The Miller/Bradley bill would require that borrowers pay 5 percent of their income regardless of the amount borrowed, but it also would limit repayments so that borrowers would pay no less than 66 percent and no more than 150 percent of what is owed based on the average gross incomes of individuals with college educations. The Petri and Simon bills put a different twist on the typical approach by varying a number of factors according to the borrower's income including: the percentage of income paid in a progressive fashion, the interest rate charged, and the length of repayment. The graph on the following page of this testimony indicates how repayment of $10,000 in loans under these plans would differ for borrowers at different income levels

PRESENT VALUE OF REPAYMENTS ON $10,000 LOAN UNDER ALTERNATIVE LOAN PROPOSALS



Each of the income contingent proposals currently before the Congress contemplates that all new student loan borrowers will repay on the basis of their incomes once they graduate or complete their education. The requirement that all borrowers repay on an income contingent basis stems from the notion that higher income borrowers are needed in the pool of repayers to help pay the costs of lower income borrowers whose repayments based on their income are not sufficient to meet their student loan obligations.

Economists use the term "cross subsidy" to describe when higher income borrowers help pay off the obligations of lower income borrowers. The advantage of using cross subsidies is that income contingency can then be self financing as wealthier borrowers make up for what lower income borrowers cannot pay. This self financing feature is the principal reason why each of the current proposals except the Committee bill and the Simon bill would require all borrowers to repay on an income contingent basis. In the graph on the preceding page, the degree to which higher income borrowers in the Petri and Miller bills would pay more than they borrowed (as indicated by the flat portion of the Simon bill) is the cross subsidy in these bills.

The disadvantage of using cross subsidies to finance student loans is that individuals who expect that their incomes will be higher tend to resist participating in a program in which they will be asked to repay more than what they owe with interest. This process of higher income borrowers opting out of income contingent plans is referred to as "adverse selection". It is difficult if not impossible to design a cross subsidized program in which adverse selection would not occur. If policymakers want to avoid adverse selection, however, alternatives to cross subsidy must be identified to finance the unmet obligations of low income borrowers.

The best way to avoid adverse selection is not to require higher income borrowers to repay more than they owe. The Simon bill would do this by ending repayments once borrowers have repaid all they owe in principal and interest. Another simpler method for avoiding cross subsidies and adverse selection is to allow those borrowers for whom student loan repayments are not a problem to continue to pay on a traditional, amortized (equal payment) basis. The Committee bill would allow this to happen by permitting income contingency at the borrower's option. Borrowers who are not having trouble with their repayments would continue to repay as they do now. Only those in trouble would avail themselves of graduated or income contingent schedules.

This notion of leaving income contingent repayment at the option of the borrower is also what is contemplated in the flexible repayment proposal put forth by the higher education associations and endorsed, I might add, by the Consumer Bankers Association. I would commend the Committee's attention to the income contingent approach that would occur under flexible repayment in that it would minimize administrative difficulties by limiting the program to those who need it. The bulk of borrowers would be able to continue repaying as they do now. What flexible repayment would do is allow students whose debts exceed their income (a good proxy measure for which borrowers are having difficulty) to petition for assistance in the form of extended, graduated, or income contingent terms.

The current loan consolidation provisions are a form of flexible repayment at least for the borrowers who qualify (those with debts in excess of $7,500). Lender forebearance is another form of existing flexible repayment in that borrowers in difficulty are excused from repayment for up to a year. But the problem with both the current consolidation and forebearance provisions is that they cost the federal government money as special allowance and other payments are larger and continue for a longer period of time than would be the case under a normal repayment schedule.

A key for making a flexible repayment system work in a cost effective way is to get the loans out of the hands of the banks and into the hands of nonprofit organizations which will not require a special allowance in order to maintain the loan. One obvious candidate for this job is the guaranty agencies. They in effect do this already when they pay off the bank for a default and then seek collection from the borrower. The only difference is now we call these borrowers defaulters, while in the case of flexible repayment, they would continue in active repayment at reduced levels for more years.

The other key for a successful flexible repayment program is to do it on an exception basis by placing responsibility on the borrower to petition for relief. Flexible repayment is not for everyone, and the way to keep it manageable is to limit its benefits to students who are willing to apply for it. For the bulk of borrowers who are not having difficulty making their repayments, they would continue to repay as they do now. Income tax forms would not be necessary for them.

This leaves the question of what to do with borrowers whose income-based repayments are not sufficient even to meet the interest on what they owe. Several options exist in this regard. One is not to reduce the obligations of lower income borrowers, but to make them pay over a longer period of time, by adding the unpaid interest to what they already owe. When interest is added to principal during repayment, "negative amortization" occurs, reflecting the fact the borrower's obligation grows over time rather than being reduced as would happen in the case of a normal repayment.

In order to be self financing, each of the proposals other the Committee bill would require negative amortization on the loans of some borrowers. This is the feature of the proposals that I find most objectionable. If borrowers cannot find work sufficient to pay off their student loan obligations, or more importantly, if they choose to take lower paying jobs, then I think it is wrong for the government to add to their loan burden through negative amortization. The Petri and Simon proposals would forgive these repayments after 25 years, but by then the damage may have already been done.

One alternative to negative amortization is to use borrower fees to pay for the costs of subsidizing low income borrowers. For example, the current origination fee and the insurance premium that guaranty agencies charge could be used to pay for the shortfall of low income borrowers. This would be a cross subsidy of sorts, but the difference is that all borrowers would contribute, not just higher income borrowers, and the fee would be charged before individuals knew what their future income would be. Or the government could decide to subsidize the costs of these low income borrowers. These costs which would be fairly minimal compared to the total current federal costs of GSL -- subsidizing the repayments of low income borrowers would cost no more than 5 percent of the initial amount borrowed, compared to the current GSL program where the federal government now pays out over 25 cents per dollar loaned in the form of interest and default payments.

My own preference in this regard is to charge a fee to all borrowers to pay the cost of low income borrowers. This would avoid both adverse selection and negative amortization, while minimizing the government's budgetary exposure. Most borrowers already pay these fees; I would propose that the purpose of these fees be clearly identified with default prevention rather than the current practice of using the fees to pay a portion of the interest costs in the program. To the extent that the government would be obligated to pay the costs over and above those covered by the fees, there would be a reduced federal budgetary exposure relative to current policy.

IRS Collection of Loans. Perhaps the most contentious issue that surrounds most income contingent proposals is that they usually require that the Internal Revenue Service to collect the loans. This proposed use of the IRS stems from the notion that if repayment is going to be tied to income, why not use the government agency that knows what everybody's income is?

One of the biggest obstacles to this in the past has been reluctance of the IRS to get into the business of student loan collection. Some observers, however, have pointed out that the IRS is already in the business in that it withholds the refunds of taxpayers who have defaulted on their student loans. But withholding refunds of defaulters is a far cry from regularly collecting on the loans of many millions of student loan borrowers.

The more important issue, in my opinion, is whether it is worth getting the IRS involved when more than 80 percent of student loan borrowers (the nondefaulters) are making their repayments on a regular basis. Why have all the borrowers in good standing subject themselves to the rigors of IRS collection when they are perfectly content and able to pay off their student loans just as they would any other type of loan? It is for this reason that I strongly favor flexible repayment to income contingency for all borrowers.

I would also like to take this opportunity to dispel a prevalent misconception about a potential benefit of IRS collection of student loans. It is often asserted that bringing the IRS into student loan collection would eliminate defaults. That is not the case. For the borrowers whose income is insufficient to repay their loans, or to even cover the interest owed, using the IRS does not mean these borrowers are any more able to repay their loans than without the IRS involvement. The IRS would certainly be helpful in reducing the fraud associated with student loans by bringing into line those borrowers who can repay but choose not to. But it should not be any more effective in getting people with little or no income to repay.

To the extent that most defaulters are in the latter category of being unable to repay rather than unwilling to pay, IRS collection will not solve the bulk of the default problem. In addition, it is possible that IRS involvement will convert some amount of what we currently call default into what reasonably might be referred to as tax evasion. That is, tying student loan repayments to the income of borrowers would increase whatever incentives currently exist for taxpayers to underreport their income.

I would like to conclude by commenting on a question which was raised previously in Senate hearings about whether these loan proposals will either lead to higher tuitions or to a greater shifting of responsibility for paying for college from the generation of parents to the generation of students.

My general response to this question is that there is no particular reason why these loan proposals would lead in this direction any more than does current policy. If loan limits are increased either in the current GSL program or in some new program, then the threat of tuition inflation exists, and steps should be taken to prevent this from happening. I have previously testified before this committee suggesting that student aid awards in both Pell Grants and GSL should be limited to the average expenditures for instruction at different types of institutions to prevent tuition inflation from occurring because of incentives currently imbedded in the student aid programs.

On the matter of intergenerational shifting of responsibilities for paying for college, as with the case of tuition inflation, the proposals before you now contain no more or less incentive for intergenerational shifting than do the current programs of student aid. In my opinion, neither direct loans nor income contingent repayments *per se* will affect this balance.

A better way to address the real question of intergenerational shifting may be to make parent loans a more attractive borrowing option than is currently the case. It is my sense that thus far in this reauthorization process Congress has paid relatively little attention to the issue of parent loans. If your concern about intergenerational shifting of responsibilities is genuine, then more should done to make parent loans a more viable alternative, either by reducing the PLUS interest rate or perhaps by allowing parents to use the federal in-school interest subsidy which previously has been available only to student borrowers. In effect, the subsidy could only be used once on each loan, but parents and their children would decide who could use it.

My Chairman, that concludes my formal testimony. I would be glad to answer questions at this time.

COMPARISON OF GSL PROGRAM AND STUDENT LOAN PROPOSALS

	Current Program	House Committee Bill	HR 2336 (Petri)	HR 3050 (Miller/Bradley)	S 1845 (Simon/Durenberger)
Direct Loans/Initial Source of Capital?	No/private capital	Yes/sale of bonds	Yes/sale of bonds and repayment of loans	Yes/surtax on millionaires and Education Trust Fund bonds	Yes/sale of bonds and repayment of loans
Supplant Existing GSL Program?	--	Yes, by 1996	No, but SLS is phased out	No	Yes
Fees Charged to Borrowers	5% origination fee; up to 3% insurance premium	none	none	none	none
Loan Limits	Stafford/ Annual: $2,625 1st yr; $4,000 other undergrad; $7,500 grad & prof Cumulative:$17,250 undergrad; $54,750 grad/prof Supplemental (SLS)/ Annual: $4,000 Cumulative: $20,000	Subsidized/Annual: $6,500 1st yr; $8,000 other undergrad; $13,000 grad Cumulative: $38,500 undergrad; $98,500 grad Unsubsidized/Annual $4,000 1st yr; $6,000 other undergrad; $10,000 grad Cumulative: $28,000 undergrad; $78,000 grad	Annual: $6,500 1st & 2nd yr; $8,000 other undergrad; $11,000 grad; $22,500 pharmacy, public health; $30,000 various medical, dental, and veterinary; Cumulative: $70,000, or less if borrower is over 35; $115,700 pharmacy, public health; $143,870 medical	Annnual: $10,000 Cumulative: $33,000	Annnual: $6,500 1st/2nd yr; $8,000 other undergrad; $11,000 grad; $20,000 med/high-cost PhD; $30,000 extra high-cost grad Cumulative: $70,000,less if borrower over 40; $100,000 med/high-cost Phd; $120,000 extra high cost grad
Interest Rate Charged to Borrowers	8% for first 4 years of repayment,10% thereafter	subsidized: 8% unsubsidized: T-bill+3.25%	91 day T-bill+2%, with a max of 10%	Average rate of 10 and 30 Year Treasury bonds, max of 10 %	91 day T-bill+2%, with a max of 10%
In-School Interest Paid by Federal Government?	Yes, for students with financial need	Yes, for students with financial need	No	No	No
Income Contingent Repayment Terms?	No	Yes, graduated and income contingent terms at borrower option, with a minimum annual repayment of $600	Yes, for all borrowers. Repayment based on progressive percentage of income	Yes, for all borrowers. Repay at 5% of income, minimum and maximum payments set at 66% and 150% of average income	Yes, for all borrowers. Repayment based on progressive percentage of income
Cross Subsidy Between Borrower Groups?	No	No	Yes	Yes	No. Repayment ends when loans are fully repaid.
Negative Amortization for Borrowers in Repayment?	No	No	Yes	Yes	Yes
Length of Repayment	10 yrs (25 yrs for consolidating)	10 yrs (more at the ED Secretary's option)	25 yrs (remaining loan forgiven after 25 yrs)	15, 20, or 25 yrs	25 yrs (remaining loan forgiven after 25 yrs)
IRS Collection?	No	No	Yes	Yes	Yes
Conversion of Existing Loans to Direct Loans or Income Contingent?	No	Yes, elective under consolidation provisions	Yes	No	Yes, mandatory for all defaulted loans, elective for others.
Estimated Federal Cost Per $1,000 Loan T-Bill=5%: T-Bill=10%:	$270 $490	$250 $280	$50 $50	$70 $70	$60 $60

Mr. Sears. Mr. Chairman, members of the committee, my name is Ken Sears and I'm the Associate Director of Student Financial Aid at West Virginia University, and I work at the Health Sciences Center Campus. In my capacity as a financial aid administrator, I've been directly involved with the awarding and management of student aid for 23 years.

I'm here today to testify on behalf of several professional school associations, including schools of allopathic medicine, dentistry, nursing, pharmacy, podiatry, optometry, veterinary medicine, public health, and programs in health administration and allied health, as well as over 200,000 students enrolled at those institutions.

I have written testimony that I would like to submit. I'll make my observations short and brief this morning because of the hour.

I need to tell you that my view is one from the trenches. I'm a foot soldier in this business of student aid. I see the students that walk through the door. Literally, I see every one of them. Because of that, I'd like to thank the committee for the current student aid programs that we have, for all of the opportunity that our students have had over the past 25 or 30 years.

If you ever need a testimonial from a student, give me a call. I know many. I can tell you about a gentleman by the name of Scott, an African-American from Paw Paw, West Virginia, who came from a family without a father. His mother survived on Social Security benefits. Scott is now a cardiologist.

I can tell you about Sherman from Cabin Creek, West Virginia. Sherman came from a foster home. He had been abused as a child. He spent his summers working in a circus so he'd have a place to stay during the summers.

Scott not only managed to negotiate the process as an undergraduate, but also managed to get himself admitted to our medical school a few years ago.

This morning, I'd like to focus my remarks on why income-sensitive repayment is beneficial to health profession students.

Indebtedness and access to financial aid are particular concerns in the health profession area. Federal grant support is available only to a small portion of our students. The vast majority of health professional students have to borrow, and they graduate with considerable debt. The programs authorized under Title IV of the Higher Education Act are critical sources of financial aid for our students. In fact, among the 1990 medical and dental school graduates, over 75 percent borrowed a Stafford Loan and nearly one-third utilized the Supplemental Loan for Students in the Perkins Loan Program.

Although it's reasonable to expect students to borrow in order to finance graduate or professional education, the escalation and the level of educational debt is causing alarm in our community. Medical and dental school graduate indebtedness has increased over 75 percent in constant dollars in the last decade. Mean debt among 1990 medical and dental students was $46,224 and $45,550, respectively.

Even more troubling than these averages are the numbers, especially of disadvantaged and minority students graduating with debts exceeding $50,000. In addition, $100,000 of educational debt is not uncommon for health profession graduates. While some students in health profession disciplines such as nursing and public health have shorter periods of in-school training and may not incur these very high debt levels, the relatively lower starting salary of these disciplines intensifies the problem of repayment.

Many health professionals in the higher-paid disciplines also experience difficulty in repaying their loans during the first few years after school, difficulties which are exacerbated when the indebted graduates opt for lower paying careers in primary care or underserved rural and inner city settings.

In order to meet successfully the challenges faced by health profession students with heavy debt loads, we need to be able to offer more grants, higher loan limits on low-interest loan programs, and offer more flexible repayment schedules. However, Federal budget constraints limit Congress' ability to offer more grants and subsidize loans. Unfortunately, the committee's reauthorization bill does not yet include these measures for health profession students.

We see three inherent advantages in the concept of an income-sensitive loan repayment program. First, income dependent repayment schedules factor in a graduates earnings and aggregate level of borrowing, thereby enabling the individual to satisfy the educational debt in a manner formulated on his or her ability to pay.

Second, income-sensitive loans promote simplicity in the financial aid process in a variety of ways, including allowing all borrowing to take place through one Title IV program, reducing paperwork burdens, eliminating the necessity of deferments or forbearance, and precluding technical defaults.

Finally, through income-sensitive repayment plans, prospective students can matriculate and borrow at the level necessary to finance an education leading to a public service career, without concern that their salary upon graduation will not support repayment at that level of debt.

In addition to easing repayment, any income-dependent loan proposal should provide borrowing options for students that are superior to the current system. A major component of this is realistic loan limits that would be sufficient to eliminate the need for health profession students to borrow from HEAL or other high-cost programs.

We believe the income-dependent loan proposals offer new and innovative structures for student financial aid. Thank you, and I'd be glad to try and respond to any questions.

[The prepared statement of Kenneth Sears follows:]

ORAL TESTIMONY
PRESENTED BY KEN SEARS
ASSOCIATE DIRECTOR OF FINANCIAL AID
WEST VIRGINIA UNIVERSITY
HEALTH SCIENCES CAMPUS
TO THE
POSTSECONDARY EDUCATION SUBCOMMITTEE
COMMITTEE ON EDUCATION & LABOR
U.S. HOUSE OF REPRESENTATIVES

ON BEHALF OF THE
AMERICAN ASSOCIATION OF COLLEGES OF NURSING
AMERICAN ASSOCIATION OF COLLEGES OF PHARMACY
AMERICAN ASSOCIATION OF COLLEGES OF PODIATRIC MEDICINE
AMERICAN ASSOCIATION OF DENTAL SCHOOLS
ASSOCIATION OF ACADEMIC HEALTH CENTERS
ASSOCIATION OF SCHOOLS OF ALLIED HEALTH PROFESSIONS
ASSOCIATION OF AMERICAN MEDICAL COLLEGES
ASSOCIATION OF AMERICAN VETERINARY MEDICAL COLLEGES
ASSOCIATION OF SCHOOLS AND COLLEGES OF OPTOMETRY
ASSOCIATION OF SCHOOLS OF PUBLIC HEALTH
ASSOCIATION OF UNIVERSITY PROGRAMS IN HEALTH ADMINISTRATION

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THURSDAY, FEBRUARY 6, 1992
9:30 a.m.

Good morning. My name is Ken Sears, I am the Associate Director of Financial Aid at West Virginia University at the Health Sciences campus. In my capacity as a financial aid administrator, I have been directly involved in the management and awarding of financial aid for the past twenty-three years. I am here today to testify on behalf of several professional school associations representing schools of allopathic medicine, dentistry, nursing, pharmacy, podiatry, optometry, veterinary medicine and public health, and programs in health administration and allied health, and academic health centers, as well as over 200,000 students enrolled at institutions providing these programs.

This morning I would like to focus my remarks on why income sensitive repayment would be beneficial to health professions students.

Indebtedness and access to financial aid are particular concerns in health professions education. Federal grant support is available only to a small portion of our students. Hence, the vast majority of our health professions students must borrow to finance their educations and graduate with considerable debt burdens. The programs authorized under Title IV of the Higher Education Act are critical sources of financial aid for our students. In fact, among the 1990 medical and dental school graduates, over 75% borrowed a Stafford loan, and nearly one third utilized the Supplemental Loan for Students (SLS) and the Perkins loan programs. Approximately 50% of nursing students and 70% of optometry students borrowed from Stafford, and two thirds of the optometry students also utilized SLS. Clearly, without Stafford Student Loans, Supplemental Loans for Students, and campus-based Perkins Loans, health professions students would find it difficult, if not impossible, to finance their education.

It is important to note, however, that Title IV loan sources do not meet fully the needs of many health professions students. As these students reach the maximum borrowing levels in Title IV subsidized programs, they are forced to rely on more expensive loans, such as the Health Education Assistance Loan (HEAL), with terms and conditions much less favorable than the

Title IV loans. HEAL borrowers currently pay an 8 percent insurance premium upon origination and are charged a floating interest rate tied to the 91-day Treasury bill. Despite the costly terms and the fact that the HEAL loan was designed as a "loan of last resort", last year HEAL was the second largest financial source behind the Stafford Student loan program for health professions students.

Although it is reasonable to expect students to borrow in order to finance graduate or professional education, the annual escalation in the level of educational debt is causing alarm in our community. Medical and dental school graduate indebtedness has increased over 75 percent in constant dollars in the last decade. Mean debt among 1990 medical and dental students was $46,224 and $45,550, respectively. Even more troubling than these averages are the numbers, especially of disadvantaged and minority students, graduating with debts exceeding $50,000. In addition, $100,000 of educational debt is not uncommon for health professions graduates. While some students in health professions disciplines such as nursing and public health have shorter periods of in-school training and may not incur these very high debt levels, the relatively lower starting salary of these disciplines intensifies the problem of repayment. Many health professionals in the higher-paid disciplines also experience difficulty in repaying their loans during the first few years after school, difficulties which are exacerbated when indebted graduates opt for lower paying careers in primary care or underserved rural and inner city settings. For example, the 1990 starting salary for a registered nurse averaged $24,768, approximately $50,000 for a general pediatrician, and approximately $40,000 for a general dentist. Some health professions graduates are interested in, but financially deterred from, such career choices. Similarly, the debt-to-income-ratio of a heavily indebted graduate can make it impossible, despite the individual's willingness, to make the required loan payments during the first few years following graduation.

It is necessary to note that many health professions students must continue in a training program, known as a residency or internship, following graduation in order to become licensed or certified. Residency training for medical school graduates lasts between three and seven years depending on the specialty, during which time the average stipend received in 1990 was approximately $27,000. Other disciplines do not require post-graduate clinical training, but many of their graduates choose to participate in internship or residency training programs to prepare them for specialty practice, such as in geriatrics. In a number of cases, these residents are required to pay tuition to participate in that supervised clinical experience. In dentistry, for example, well over half of those graduates who participate in residency programs pay tuition and receive little if any stipend. Loan repayment is particularly problematic for residents and interns.

In order to meet successfully the challenges faced by health professions students with heavy debt loads, we need to be able to offer more grants, higher loan limits on low interest loan programs, and offer more flexible repayment schedules. These steps would decrease the number of students with enormous debt, create a better balance between the grant and loan aid available, reduce overall debt burdens, curtail the instance of default, ease repayment, and facilitate the ability of health professionals to afford lower income positions in underserved areas as well as careers in primary care, teaching or research. However, federal budget constraints limit Congress' ability to offer more grants and subsidized loans, and unfortunately, the Committee's Reauthorization bill does not yet include these measures for health professions students.

We see three inherent advantages in the concept of a income-sensitive loan repayment program. First, income dependent repayment schedules factor in a graduate's earnings and aggregate level of borrowing, thereby enabling the individual to satisfy the educational debt in a manner formulated on his or her ability to pay. Second, income sensitive loans promote simplicity in the financial aid process in a variety of ways, including allowing all borrowing to take place through one Title IV program, reducing paper work burdens, eliminating the necessity of deferments or forbearance, and precluding technical defaults. Finally, through income sensitive repayment plans, prospective students can matriculate and borrow at the level necessary to finance an education leading to a public service career, without concern that their salary upon graduation will not support repayment at that level of debt.

In addition to easing repayment, any income-dependent loan proposal should provide borrowing options for students that are superior to the current system. A major component of this is realistic loan limits that would be sufficient to eliminate the need for health professions students to borrow from HEAL or other high cost programs. In setting higher loan limits and longer repayment periods, we recognize that some health professions students may pay slightly more over the life of a loan than would be the case under existing standards. This point is neutralized by the fact that borrowers would be offered an option that is responsive to the timing of their ability to repay the debt and that they could borrow with confidence that they could service the debt over time. Apprehensions related to a borrower's ability to meet educational debt obligations exists in the current system. Income sensitive repayment would remove this element of fear and represent a positive step for students, institutions, and the government.

We believe the income dependent loan proposals offer new and innovative structures for student financial aid. We would be pleased to discuss this further with committee staff and help develop details that are related to this program. On behalf of the associations I am here to represent, I thank the Committee for allowing us to make these comments. I will be happy to respond to questions or to clarify or expand on my remarks.

Mr. DAVIS. Good afternoon. I'm Jerry Davis, Vice President for Research and Policy Analysis for the Pennsylvania Higher Education Assistance Agency; that's the agency that administers State financial aid programs and guarantees Federal loans in the commonwealth.

We don't grow tobacco. I make that comment because Senator Simon indicated that sometimes agencies such as ours have a vested interest that clouds our testimony. I would like to say that we have calculated that if there were a direct lending program, as proposed in either the Senate or the House versions, that our agency would make more money than we make right now. So, it isn't a monetary or a financial issue with us.

I would like to just summarize my testimony, the written testimony that you have. I appreciate what I assume must be a primary motivation behind both of the income-contingent loan proposals, and that is to reduce borrower repayment burdens and the potential for defaults. Trying to help ease borrower repayment burdens is laudable. However, I think some compelling evidence indicates that undergraduate Stafford Loan debts are not skyrocketing.

The baccalaureate graduates in Pennsylvania, where the college costs are higher than they are in the rest of the Nation, and where student access to loans is not restricted by need analysis, as it is elsewhere, these college graduates in Pennsylvania are funding the same proportion of their education costs with Stafford Loans in 1991 as they were 5 years ago.

A typical Bachelor degree recipient from Pennsylvania now leaves school owing about $10,000. Now, experience and research have shown that when loan payments reach 10 percent of a borrower's gross income, they become burdensome and often lead to default. When I looked at the 1989 earnings of persons with 4 years of college who were between ages 25 and 34—these are the years most borrowers will be repaying their loans—I found that 23 percent would have incurred debt burdens. That is, their annual payments would have represented 10 percent of their annual earnings if they had borrowed today's typical $10,000 amount.

Over 7 out of 10 of the graduates with debt burdens would have been females because they earn so much less than males. They also were five times as likely as males to have had no earnings. About 29 percent of the black graduates would have experienced debt burdens because their average earnings were less than those of white graduates, $22,000 versus $28,000.

So, only a fourth of the baccalaureate graduates would have had debt burdens at the typical $10,000 level of borrowing. But female and minority borrowers would be much more likely than others to have had burdens. The evidence indicates that debt burdens are more a function of borrower earnings than the amounts they borrow.

Now, because loan debts are not rising to levels that are burdensome for the majority of undergraduates, and because existing repayment burdens are not distributed evenly among all student groups, offering income contingent loan programs to everyone may be unnecessary and unwise.

I'm generally opposed to income-contingent loan programs. The basic problem I have with them is that borrowers do not and cannot know how much it will cost to repay their loans when they accept them. If they cannot know this, then they cannot know how much their education will actually cost.

If they can't know what their education will actually cost, then they can't make intelligent and informed cost benefit analysis. They cannot access the relative value of attending institutions of widely different costs because they cannot compare the net cost; that is, the cost after financial aid of the alternative choices.

I think virtually all income-contingent loan programs allow, if not encourage, borrowers to incur larger debts than fixed payment programs. Larger debts are made possible because payments frequently, but not always, represent smaller proportions of the borrower's income upon graduation when their earnings are less. But smaller loan payments made over many years ultimately mean that the total payments for a given amount borrowed will be greater than the payments made for a fixed payment loan, such as a Stafford Loan.

It's impossible to escape the mathematics of the PRT equation, principal times rate times time, unless at some point interest is foregone, a portion of the principal is forgiven, or time collapsed. When student loans cost more, than so does the education purchased with them, regardless of the fact that paying for the education is spread over many more years.

When I compared the borrower's total repayments for $1,000 in Stafford Loans and the same amount borrowed under the IDEA and the Self-Reliance scholarship programs, I found them to be from 15 to 83 percent higher under the income-contingent plans. The differences for the borrowers who earned the least are dramatic.

When a borrower initially earns $13,000, and his income grows by 5 percent per year, he will eventually pay $27,518 for an IDEA Loan and about, I think, around $21,000 for a Self-Reliance Scholarship Loan, the differences of 83 and 40 percent, respectively. At the end of the 25 years of payments, IDEA borrowers who initially earned $13,000 would still owe over $9,000 in principal and interest, which the government would then forgive.

Now, it's clear that borrowers with below-average earnings will have to pay more for IDEA and Self-Reliance Loans than will their more affluent peers in absolute dollars and proportions of their income. In other words, if you were a low-income earner and you accept a loan under either one of these income-contingent programs, you're going to have to pay more in absolute and proportionate terms.

Now, this means that the two proposals would discriminate against women and minorities and borrowers who entered lower paying professions, such as teachers and the ministry. Rather than reducing the disincentive to borrow when a student is considering a lower-paying occupation, both the proposals add to the disincentive and exacerbate the negative effects of education costs on choices of institutions, majors and future careers.

Now, I know that some believe that income-contingent loans will solve the default problem. This is wishful thinking. Borrowers default on their loans primarily because they do not have enough money to make the loan payments. The education and training defaulters paid for with loans did not sufficiently enhance their ability to earn enough additional money to repay their loans. This generalization applies at every level of postsecondary education.

Income-contingent loan programs assume that all borrowers will have incomes. But in 1989, 7 percent of the 4-year college graduates between age 25 and 34 had no earnings, and another 16 percent earned less than $12,500. Now, giving students income-contingent loans will not ensure that they have incomes or incomes substantial enough to amortize their loans.

It may be considered impossible to default on an income-contingent loan, but it is very possible to not repay them. Failure to repay them will cost the government money or the other borrowers of the income-contingent loan, depending if you're having cross funding.

Income-contingent loan programs can help reduce borrower's debt burdens when they experience lower earnings, but so can forbearances and deferments and graduated repayment schedules that are offered in the current programs. I think the best way to reduce defaults is not through income-contingent loans, but is through assuring that the education and the training paid for with loans is of the highest quality and enhances the student borrowers ability to secure a good job with an adequate salary.

Another way to reduce defaults is to provide students who enter quality programs but have academic, socioeconomic or other disabilities which are likely to inhibit their success with a grant instead of a loan, an income-contingent loan or otherwise.

When students are at risk, there is no social justice in making them share the majority of the risk of trying to improve their conditions through education paid for with loans when failure and consequent default on those loans leave them worse off than had they not attempted to improve themselves in the first place.

When considering ways to reduce debt burdens and loan defaults, the persons who are responsible for providing financial aid to the Nation's students should take to heart a primary tenet in the physician's code of ethics. First, do no harm. I think the income-contingent loan program proposals before you will, if implemented, do considerable harm and won't solve the problems that they're intended to address.

Thank you for your consideration of my remarks.

[The prepared statement of Jerry Davis follows:]

PHEAA
Creating Access to Education

A COMPARISON OF BORROWER LOAN REPAYMENT COSTS UNDER THE SIMON-DURENBURGER IDEA LOAN PROPOSAL AND THE STAFFORD STUDENT LOAN PROGRAM

by

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The Simon-Durenburger IDEA proposal's repayment schedules as offered to the media when the bill was introduced make the proposal look much more attractive in comparison to the current system than it would be in reality. First of all, the media repayment schedules assumed total cumulative debts under the current system that are much different from reality. For example, here are the average amounts assumed and the actual average amounts borrowed by Pennsylvania students who entered repayment during FFY 1991 after completing four years at a public university:

Income Groups	IDEA Assumption	PHEAA Staffords
Low Income	$ 9,600	$9,715
Middle Income	$18,000	$9,730
High Income	$18,000	$8,910

By using extraordinary amounts borrowed under the current system, the media handouts did not offer a legitimate comparison of repayment costs under the current system and the IDEA proposal.

The more important problem with the IDEA media handouts lies in the comparisons of proportions of monthly incomes devoted to repayments under IDEA and the current system. The handouts appropriately described these proportions in terms of monthly payments, but did not describe how many payments borrowers would have to make to amortize their loans under different circumstances.

This paper compares the repayment schedules for borrowers who accept $10,000 in total Stafford or IDEA loans for four years of undergraduate study when the borrowers have four different starting incomes, as defined by the media handouts. They are: Low Starting Income Borrowers, those who would earn only $9,750 in their first repayment year; Average Starting Income Borrowers, $13,000; High Starting Income Borrowers, $26,000; and Higher Starting Income Borrowers, $36,000. The analyses demonstrate that the IDEA proposal would cost more students more for their education loans than the current Stafford Loan program and very well might cost the federal government more as well.

It was assumed that all borrowers would borrow $2,500 each year for four years and that they would repay their loans under the current Stafford Loan provisions or the proposed IDEA provisions. Table One shows amounts borrowers would have to repay for their Stafford loans. Their monthly payments are $121 for the first four years (at 8 percent interest) and $128 for the next six years (at 10 percent interest), for a grand total of $15,052 for the $10,000 borrowed.

All borrowers' repayment schedules are the same, regardless of their starting incomes. The right half of the table shows the percentages of different incomes represented by the monthly/annual repayments. All incomes were inflated by 5 percent per year. Thus the Low Starting Income group is assumed to earn $10,238 in the second year of repayment ($9,750 times 1.05 equals $10,237.50), $10,749 in the third year of repayment ($10,237.50 times 1.05 equals $10,749.38), and so on.

Low Starting Income borrowers have to spend from 14.9 percent to 10.2 percent of their incomes to amortize their loans in ten years. The Average Starting Income borrowers have to spend from 11.2 percent to 7.6 percent; the High Starting Income borrowers, from 5.6 percent to 3.8 percent; and the Higher Starting Income borrowers, from 4.0 percent to 2.8 percent. All borrowers repay $15,052, or 50.5 percent more than the amount borrowed. They repay 63.6 percent more than the $9,200 they would have received to spend for education ($10,000 less a 5 percent origination fee and a maximum 3 percent insurance premium).

What happens to repayment schedules under IDEA for $10,000 borrowed? The first thing that happens is that $10,000 becomes $12,166 by the time the borrower leaves school, because interest is capitalized each year and the borrower has to pay 8 percent interest on the accumulated interest. Therefore, by the time borrowers leave school, they would owe 21 percent more in the IDEA program than in the Stafford Loan program in which the government pays the in-school interest.

Table Two shows the repayment schedule for IDEA for the Low Starting Income Borrowers who got $10,000 in loans. Here is how to read the table. Annual incomes are inflated by 5 percent each year. It is necessary to subtract the Standard Deduction from income each year because, according to the bill, "the annual amount payable by the taxpayer for any taxable year shall be the lesser of (i) the product of (I) the base amortization amount, and (II) the progressivity factor for the taxpayer for such taxable year, or (ii) 20 percent of the excess of (I) the modified adjusted gross income of the taxpayer for such taxable year, over (II) the sum of the standard deduction and any exemption amount applicable to such taxpayer's income tax return for the taxable year."

Therefore, in the second column of Table Two, the Standard Deductions are subtracted from annual income to get an amount called adjusted gross income. Multiplying AGI by 0.20 yields the second (ii) criterion for annual repayments, which is listed in the fourth column under "X 0.2."

The first criterion (i) for the annual repayment is the base year times the progressivity factor. The IDEA bill defines base year amortization amounts as "the amount which, if paid at the close of each year for a period of 12 consecutive years, would fully repay (with interest) at the close of such period the maximum account balance of the borrower. For purposes of the preceding sentence, an 8 percent annual rate of interest shall be assumed."

To amortize a $12,166 debt over 12 years requires annual payments of $1,580, the "Base Amount" listed in the fifth column. The sixth column contains the progressivity factors given in the bill for different incomes and taxpayer statuses. So, for Low Starting Income Borrowers the annual payment amount is $790, the lessar of 20 percent of AGI or 50 percent of the base amount of $1,580. The last column shows the Remaining Balance owed by borrowers at the end of the year after making the annual payments.

Note that the annual payment amount for the first year (and subsequent years) does not cover the 8 percent interest that is accruing. Therefore, the Remaining Balances increase each year. Since Remaining Balances increase, new Base Amounts have to be calculated, because the bill says that the Base Amount is "the maximum account balance of the borrower."

Note that the Remaining Balances the Low Starting Income Borrowers owe on their loans increase until repayment Year 18. This is because annual payments don't cover the accruing interest. Note also that by the end of repayment Year 25, borrowers still owe $14,650 on the $10,000 borrowed for education. And they will have made a total of $27,288 in repayment on the loans for the 25 years they were paying on them. So borrowers pay $27,288 for a $10,000 loan AND the government ends up having to forgive $14,650 in loan debt at the end of the repayment schedule. It would have cost the government less to give these borrowers the $10,000 outright.

Table Three shows the repayment schedule for Average Starting Income Borrowers, i.e., those who make $13,000 in their first repayment years. Here the same taxable income pattern for Low Starting Income Borrowers is followed, i.e., borrowers remain single through repayment Year 4, are married in repayment Years 5 through 10, and are married with one child in repayment Year 11 and thereafter. Those borrowers' annual payments do not cover their accruing interest until Year 12, so the remaining balance owed increases until then. By the end of 25 years in repayment, these borrowers will have paid $27,518 on their original $10,000 loans and the government will have to forgive $9,218 in debt.

High Starting Income Borrowers should be able to totally amortize the original debt. The data are displayed in Table Four. Borrowers who earn $26,000 in their initial year of repayment and 5 percent more each year thereafter will take 16 years to repay their loans. Their repayment amount will total $22,028, 120 percent more than they borrowed, and 46.3 percent more than they would have had to pay for $10,000 in Stafford Loans.

Table Five displays the repayment schedule for Higher Starting Income Borrowers, those who initially earn $36,000 per year. These borrowers amortize their loans in 12 years, repaying $18,958. This amount is 89.5 percent more than they borrowed and 25.9 percent more than they would have had to pay for $10,000 in Stafford Loans.

Table Six compares the basic data for the four borrower income groups. Under the IDEA proposal, borrowers would have to pay from 25.9 percent to 82.8 percent more than they would have to pay for similar amounts of Stafford Loans. While under the Stafford Loan program borrowers repay 63.6 percent more than the amounts they actually were able to use on education (receiving $9,200 and repaying $15,052), IDEA borrowers would have to pay from 89.6 percent to 175.2 percent more than they received for their education. If the one-fourth of IDEA borrowers are in each of the four groups, they would pay, on the average, 139 percent more than they borrowed. And they would pay 59.1 percent more than they would have had to pay if they had had Stafford Loans.

Perhaps the worst outcome of the IDEA proposal is that students who financially benefited the least from their education, Low Starting Income Borrowers, have to pay 43.9 percent more for their loans than students who benefited the most, Higher Starting Income Borrowers, $27,288 versus $18,958. The senators asserted that the IDEA program would benefit borrowers with lower starting incomes and reduce the negative effects borrowing has for students who want to enter lower-paying occupations. The data show that this is not the case. Borrowers with the lowest incomes pay more, much more, for their loans.

The basic problem with the IDEA repayment schedules lies in the fact that borrowers are allowed more time to repay their loans. As any borrower knows, taking more time to repay any loan raises total repayment costs. In an attempt to reduce some borrowers' repayment burdens in their early years of repayment, the IDEA proposal places a greater overall repayment requirement on all borrowers.

How much does the IDEA repayment schedule reduce repayment burdens? Table Seven shows the percent of income paid to loans under the Stafford and IDEA programs for the four borrower groups' repayment years. In Years 1 through 10, Low Starting Income Borrowers pay about 12.3 percent of their incomes in Stafford payments but only 6.3 percent of their incomes for IDEA payments. But after Year 10, IDEA borrowers have to continue to make payments for another 15 years at about 5.7 percent of their incomes. Average Starting Income Borrowers pay about 9.2 percent of their salaries to Stafford Loans for ten years, while IDEA borrowers would be paying only 5.6 percent. But, under the IDEA plan, these borrowers would pay 4.0 percent of their incomes for another 15 years.

For their first ten years in repayment, High Starting Income Borrowers would pay 4.6 percent of their incomes for Stafford Loans and 4.3 percent for IDEA loans, a negligible difference. To achieve this "lower debt burden," these IDEA borrowers would have to pay 3.3 percent of their annual incomes for six additional years. The reduced percentages of income paid to IDEA loans by Higher Starting Income Borrowers is equally negligible. They would pay 3.3 percent of their incomes for ten years for IDEA loans and 3.5 percent of them for Stafford Loans. And then IDEA borrowers would have two additional years of payments, at about 2.6 percent of their incomes.

It can be argued that lowest-income students will have to borrow less under the total bill, because they will get more grants to pay for their education. However, the lowest-income students will not necessarily be the lowest-income borrowers. Students who come from middle-income and higher-income families will have less access to grants and will have to borrow more to meet their educational costs. If they do this, and do not enter higher-paying occupations, then the IDEA program will cost them much more for their education than the Stafford Loan program. And because so many loans for lowest-income borrowers will have to be forgiven, the IDEA program might cost the federal government more than if it provided Stafford Loans or even grants to students from middle- and higher-income families.

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Table One
Interest Paid and Loan Amounts As a Portion of Salaries, For Stafford Loan of $10,000

	Interest Paid	Monthly Payment	Percent of Income to Loans			
			Low	Average	High	Higher
Year 1	$775	$121	14.9%	11.2%	5.6%	4.0%
Year 2	719	121	14.1	10.6	5.3	3.8
Year 3	658	121	13.5	10.1	5.1	3.7
Year 4	591	121	12.9	9.6	4.8	3.5
Year 5	652	128	13.0	10.2	4.9	3.5
Year 6	559	128	12.3	9.3	4.6	3.3
Year 7	457	128	11.8	8.8	4.4	3.2
Year 8	343	128	11.2	8.4	4.2	3.0
Year 9	218	128	10.7	8.0	4.0	2.9
Year 10	80	128	10.2	7.6	3.8	2.8
Total	$5,052	$125	13.5%	9.3%	4.6%	3.4%

Low Income = $9,750; Average Income = $13,000; High Income = $26,000; Higher Income = $36,000.

All incomes inflate by 5 percent per year.

Loan interest rate is 8 percent per year.

Table Two
IDEA Repayment Schedule For $10,000 Borrowed and Earning $9,750 Upon Graduation

Year	Annual Income	Standard Deduction	AGI	X 0.2	Base Amount	Prog. Factor	Annual Payment	Remaining Balance
1	$9,750	$5,300	$4,450	$890	$1,580	0.5	$790	$12,356
2	10,237	"	4,937	987	1,605	"	803	12,549
3	10,749	"	5,449	1,090	1,630	"	815	12,746
4	11,287	"	5,987	1,197	1,655	"	827	12,945
5	11,851	$9,550	2,351	470	1,680	"	470	13,532
6	12,444	"	2,894	579	1,755	"	579	14,055
7	13,066	"	3,516	703	1,810	"	703	14,493
8	13,719	"	4,169	834	1,862	"	834	14,831
9	14,405	"	4,855	971	1,902	"	951	15,076
10	15,125	"	5,574	1,115	1,958	"	979	15,312
11	15,188	$11,600	4,281	856	1,989	"	856	15,696
12	16,675	"	5,075	1,015	2,039	0.571	1,015	15,791
13	17,509	"	5,909	1,182	2,051	"	1,171	15,887
14	18,385	"	6,785	1,357	2,064	"	1,178	15,984
15	19,304	"	7,704	1,541	2,076	"	1,186	16,081
16	20,269	"	8,669	1,734	2,089	"	1,193	16,179
17	21,282	"	9,682	1,936	2,102	"	1,200	16,278
18	22,346	"	10,746	2,149	2,115	0.643	1,360	16,219
19	23,464	"	11,864	2,373	2,107	"	1,355	16,160
20	24,637	"	13,037	2,607	2,099	"	1,350	16,097
21	25,869	"	14,219	2,854	2,091	"	1,345	16,039
22	27,162	"	15,562	3,112	2,083	0.786	1,638	15,672
23	28,520	"	16,920	3,384	2,036	"	1,600	15,313
24	29,946	"	18,346	3,669	1,989	"	1,563	14,963
25	31,444	"	19,844	3,969	1,944	"	1,527	14,650
Total	$464,633						$27,288	

Borrower remains single through Year Four; Married in Year Five through Ten; and Married with one child thereafter. Income grows at 5 percent per year.

Table Three
IDEA Repayment Schedule For $10,000 Borrowed and Earning $13,000 Upon Graduation

Year	Annual Income	Standard Deduction	AGI	X 0.2	Base Amount	Prog. Factor	Annual Payment	Remaining Balance
1	$13,000	$5,300	$7,700	$1,540	$1,580	0.533	$842	$12,302
2	13,650	"	8,350	1,670	1,598	"	852	12,440
3	14,333	"	9,033	1,807	1,616	0.600	970	12,467
4	15,049	"	9,749	1,950	1,619	"	972	12,494
5	15,802	$9,550	6,252	1,250	1,624	0.500	812	12,689
6	16,592	"	7,042	1,408	1,648	"	824	12,888
7	17,421	"	7,871	1,574	1,674	0.571	956	12,966
8	18,292	"	8,742	1,748	1,684	"	962	13,045
9	19,207	"	9,657	1,931	1,695	"	968	13,124
10	20,167	"	10,617	2,123	1,705	"	973	13,203
11	21,175	$11,600	9,575	1,915	1,715	"	979	13,283
12	22,234	"	10,634	2,127	1,725	0.643	1,109	13,235
13	23,346	"	11,746	2,349	1,719	"	1,105	13,187
14	24,513	"	12,913	2,583	1,713	"	1,101	13,139
15	25,739	"	14,139	2,828	1,708	"	1,097	13,091
16	27,026	"	15,426	3,085	1,701	0.786	1,337	12,792
17	28,379	"	16,779	3,356	1,662	"	1,306	12,500
18	29,796	"	18,196	3,639	1,624	"	1,276	12,214
19	31,286	"	19,686	3,936	1,587	"	1,247	11,934
20	32,850	"	21,250	4,250	1,550	0.893	1,384	11,489
21	34,492	"	22,892	4,578	1,492	"	1,333	11,060
22	36,217	"	24,617	4,923	1,437	"	1,283	10,647
23	38,028	"	26,428	5,286	1,383	"	1,235	10,250
24	39,929	"	28,329	5,666	1,332	1.000	1,332	9,720
25	41,926	"	30,326	6,065	1,263	"	1,263	9,218
Total	$620,449						$27,518	

Borrower remains single through Year Four; Married in Year Five through Ten; and Married with one child thereafter. Income grows at 5 percent per year.

Table Four
IDEA Repayment Schedule For $10,000 Borrowed and Earning $26,000 Upon Graduation

Year	Annual Income	Standard Deduction	AGI	X 0.2	Base Amount	Prog. Factor	Annual Payment	Remaining Balance
1	$26,000	$5,300	$20,700	4,140	$1,580	0.867	$1,370	$11,744
2	27,300	"	22,000	4,400	"	"	"	11,328
3	28,665	"	23,365	4,673	"	"	"	10,927
4	30,098	"	24,798	4,960	"	"	"	10,540
5	31,603	$9,550	22,053	4,411	"	0.786	1,242	10,161
6	33,183	"	23,633	4,727	"	0.893	1,411	9,568
7	34,842	"	25,292	5,058	"	"	1,411	9,009
8	36,585	"	27,035	5,407	"	"	1,411	8,484
9	38,413	"	28,863	5,773	"	"	1,411	7,988
10	40,335	"	30,785	6,157	"	1.0	1,580	7,010
11	42,351	$11,600	30,751	6,150	"	1.0	1,580	5,952
12	44,469	"	32,869	6,574	"	1.0	1,580	4,807
13	46,692	"	35,092	7,018	"	1.0	1,580	3,067
14	49,027	"	37,427	7,485	"	1.0	1,580	1,682
15	51,478	"	39,878	7,976	"	1.0	1,580	182
16	54,052	"	$42,452	8,490	$182	1.0	182	0
Total	$615,093						$22,028	

Borrower remains single through Year Four; Married in Year Five through Ten; and Married with one child thereafter. Income grows at 5 percent per year.

Table Five
IDEA Repayment Schedule For $10,000 Borrowed and Earning $36,000 Upon Graduation

Year	Annual Income	Standard Deduction	AGI	X 0.2	Base Amount	Prog. Factor	Annual Payment	Remaining Balance
1	$36,000	$5,300	30,700	6,140	$1,580	1.0	$1,580	$11,536
2	37,800	"	32,500	6,500	"	"	"	10,854
3	39,690	"	34,390	6,878	"	"	"	10,115
4	41,675	"	36,375	7,275	"	"	"	9,315
5	43,758	$9,550	34,208	6,842	"	"	"	8,448
6	45,946	"	36,396	7,279	"	"	"	7,510
7	48,243	"	38,693	7,739	"	"	"	6,494
8	50,656	"	41,106	8,221	"	"	"	5,393
9	53,188	"	43,638	8,728	"	"	"	4,201
10	55,848	"	46,298	9,260	"	"	"	2,910
11	58,640	$11,600	47,040	9,408	"	"	"	1,512
12	61,572	"	49,972	9,994	1,578	"	1,578	0
Total	$573,016						$18,958	

Borrower remains single through Year Four; Married in Year Five through Ten; and Married with one child in Years Eleven and Twelve; Income grows by 5 percent per year.

Table Six
Comparisons of Amounts Borrowed and Repaid Under Stafford and IDEA Loan Programs, By Borrower Incomes

	Low Income			Average Income		
	Stafford	IDEA	Difference	Stafford	IDEA	Difference
Borrowed	$10,000	$10,000	0.0%	$10,000	$10,000	0.0%
Available for Education	$9,200	$10,000	+ 8.7	$9,200	$10,000	+ 8.7%
Owed at Graduation	$10,000	$12,166	+21.7	$10,000	$12,166	+21.7%
Amount Repaid	$15,052	$27,288	+81.3	$15,052	$27,518	+82.8%
Repaid/Available	1.636	2.729	+66.8	1.636	2.752	+68.2%
Government Forgives	None	$14,650	--	None	$9,218	--

	High Income			Higher Income		
	Stafford	IDEA	Difference	Stafford	IDEA	Difference
Borrowed	$10,000	$10,000	0.0%	$10,000	$10,000	0.0%
Available for Education	$9,200	$10,000	+ 8.7	$9,200	$10,000	+ 8.7%
Owed at Graduation	$10,000	$12,166	+21.7	$10,000	$12,166	+21.7%
Amount Repaid	$15,052	$22,028	+46.3	$15,052	$18,958	+25.9%
Repaid/Available	1.636	2.203	+34.7	1.636	1.896	+15.9%
Government Forgives	None	None	--	None	None	--

Table Seven
Percent of Income to Loans Under Stafford and IDEA Programs For $10,000 Principal, By Income Groups and Repayment Years

	Low Income		Average Income		High Income		Higher Income	
Year	Stafford	IDEA	Stafford	IDEA	Stafford	IDEA	Stafford	IDEA
1	14.9%	8.1%	11.2%	6.5%	5.6%	5.3%	4.0%	4.4%
2	14.1	7.8	10.6	6.2	5.3	5.0	3.8	4.2
3	13.5	7.6	10.1	6.8	5.1	4.8	3.7	4.0
4	12.9	7.3	9.6	6.5	4.8	4.6	3.5	3.8
5	13.0	4.0	10.2	5.1	4.9	3.9	3.5	3.6
6	12.3	4.7	9.3	5.0	4.6	4.3	3.3	3.4
7	11.8	5.4	8.8	5.5	4.4	4.0	3.2	3.3
8	11.2	6.1	8.4	5.3	4.2	3.9	3.0	3.1
9	10.7	6.6	8.0	5.0	4.0	3.7	2.9	3.0
10	10.2	6.5	7.6	4.8	3.8	3.9	2.8	2.8
11	0.0	5.6	0.0	4.6	0.0	3.7	0.0	2.7
12	0.0	6.1	0.0	5.0	0.0	3.6	0.0	2.6
13	0.0	6.7	0.0	4.7	0.0	3.4	0.0	0.0
14	0.0	6.4	0.0	4.5	0.0	3.2	0.0	0.0
15	0.0	6.1	0.0	4.3	0.0	3.1	0.0	0.0
16	0.0	5.9	0.0	4.9	0.0	0.3	0.0	0.0
17	0.0	5.6	0.0	4.6	0.0	0.0	0.0	0.0
18	0.0	6.1	0.0	4.3	0.0	0.0	0.0	0.0
19	0.0	5.8	0.0	4.0	0.0	0.0	0.0	0.0
20	0.0	5.5	0.0	4.2	0.0	0.0	0.0	0.0
21	0.0	5.2	0.0	3.9	0.0	0.0	0.0	0.0
22	0.0	6.0	0.0	3.5	0.0	0.0	0.0	0.0
23	0.0	5.6	0.0	3.2	0.0	0.0	0.0	0.0
24	0.0	5.2	0.0	3.3	0.0	0.0	0.0	0.0
25	0.0	4.9	0.0	3.0	0.0	0.0	0.0	0.0

PHEAA
Creating Access to Education

TESTIMONY

for the

U. S. HOUSE OF REPRESENTATIVES
SUBCOMMITTEE ON POSTSECONDARY EDUCATION

prepared by

DR. JERRY SHEEHAN DAVIS,
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February 6, 1992

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Good morning. I am Jerry Davis, vice president for research and policy analysis for the Pennsylvania Higher Education Assistance Agency, the agency that administers state financial aid programs and guarantees federal student loans in the Commonwealth. I am pleased to be here to offer testimony on two income-contingent loan programs proposed in bills before the Subcommittee, the Income Dependent Education Assistance Act (IDEA) and the Self-Reliance Scholarship Act (SRS). As a part of my written testimony, I ask that a paper I wrote in November, 1991, which compared borrower loan repayment costs under IDEA and the Stafford Loan program, be entered in the record, since I will refer to it in my remarks today.

I very much appreciate what I assume must be a primary motivation behind both income-contingent loan proposals, reducing borrower repayment burdens and the potential for defaults. Trying to help ease borrower repayment burdens is laudable. However, before commenting on the two proposals, I want to offer some evidence that student indebtedness is not rising as rapidly, nor are loan debts as burdensome, as many are led to believe.

Some Pennsylvania data are helpful here. Table 1 shows the changes in average Stafford Loan indebtedness for baccalaureate graduates from our public and private colleges during the past five federal fiscal years. The average debt increased by about 26 percent. Costs increased by over 33 percent in those years. But borrowers who left school in each of the five years had paid for similar proportions of their cumulative costs of education with Stafford Loans, about 27 percent at public colleges and 17 percent at private colleges.

Pennsylvania's college costs are among the highest in the nation, so more Pennsylvanians than students in other states need to borrow to finance their education. While students in other states have their access to Stafford Loans restricted by need analysis, we offer students non-need-based Stafford Loans through our state-funded nonsubsidized loan program. So borrowing is not restricted only to students who can demonstrate financial need for the funds. Therefore, because our costs are higher and access to loans is not restricted, our students' loan indebtedness is higher and must have risen at a much higher rate than did loan indebtedness for students elsewhere. If the average debt grew at a slower pace than average costs in Pennsylvania, then the situation in other states must be much better. Thus I think it is safe to say that loan debt among the nation's undergraduates is not skyrocketing, and is likely growing more slowly than educational costs.

We can assume with some confidence that the "typical" four-year college graduate leaves school today owing around $10,000 in Stafford Loans. Experience and research have shown that when loan payments reach 10 percent of a borrower's gross income, they become burdensome, often leading to default. For how many and what kinds of borrowers might loan payments on $10,000 in debt be burdensome?

Table 2 shows the 1989 total annual money earnings of persons with four years of college who were between ages 25 and 34. Earnings for this age group are particularly relevant, because these are the years most borrowers will be repaying their loans. Note that the average earning was $27,216, but 6.8 percent of graduates had no earnings and another 16.2 percent earned under $12,500. (If you ever wondered why borrowers default on their loans, here is

Table 1
Average Cumulative Stafford Indebtedness For Pennsylvania Baccalaureate Graduates of Four-Year Colleges, Average Annual Costs, and Loans As A Percent of Costs, FFY 1987 to FFY 1991

Four-Year Public Colleges

	Avg Loan	Percent Change	Avg Cost	Percent Change	Avg Loan/Cumulative 4-Yr Avg Costs
1987	$7,454	--	$6,895	--	29.3%
1988	7,769	+ 4.2%	7,265	+ 5.4%	28.9
1989	8,506	+ 9.5	7,895	+ 8.7	30.1
1990	9,150	+ 7.6	8,370	+ 6.0	29.7
1991	9,478	+ 3.6	9,235	+10.3	29.7
1987-1991	+$2,024	+27.2%	+$2,340	+33.9%	+ 0.4%

Four-Year Private Colleges

	Avg Loan	Percent Change	Avg Cost	Percent Change	Avg Loan/Cumulative 4-Yr Avg Costs
1987	$8,062	--	$13,150	--	17.1%
1988	8,337	+ 3.4%	14,320	+ 8.9%	16.4
1989	9,232	+10.7	14,865	+ 3.8	17.0
1990	9,875	+ 7.0	16,055	+ 8.0	16.9
1991	10,154	+ 2.8	17,505	+ 9.0	16.1
1987-1991	+$2,092	+25.9%	+$4,355	+33.1%	- 1.0%

Table 2
1989 Total Money Earnings of Persons With Four Years of College Education, By Gender and Race, Ages 25 to 34

	All Males	All Females	Total	White Males	White Females	Black Males	Black Females
Without Earnings	2.4%	10.9%	6.8%	1.6%	10.7%	5.7%	4.3%
Under $12,500	11.4	20.8	16.2	10.4	20.6	24.3	24.2
$12,500-$17,499	6.5	11.0	8.8	6.4	10.7	4.4	13.0
$17,500-$22,499	13.7	16.4	15.1	13.1	17.1	24.3	15.6
$22,500-$24,999	5.9	6.3	6.1	5.9	6.1	6.9	10.5
$25,000-$29,999	13.4	12.2	12.8	13.5	11.8	23.5	14.4
$30,000-$39,999	21.7	14.6	18.0	22.6	15.2	4.4	10.8
$40,000-$49,999	12.2	5.0	8.5	12.9	5.0	1.6	4.7
$50,000 or Above	12.8	2.8	7.7	13.6	2.8	4.9	2.5
All Earnings	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Avg Earning	$32,465	$22,247	$27,216	$33,251	$22,277	$23,280	$21,646
Pct in Group	48.6%	51.4%	100.0%	42.5%	44.6%	3.6%	4.0%

Source: U. S. Bureau of the Census, Current Population Reports, Series P-60, No. 172, *Money Income of Households, Families and Persons in the United States: 1988 and 1989*.

one answer: many of them have no money to make payments.) Average earnings of females were much lower than those of males, $22,247 versus $32,465. And 10.9 percent of females had no earnings, while another 20.8 percent earned under $12,500. So it is reasonable to expect females to have greater debt burdens than males. (There is no evidence to suggest that borrowing patterns of males and females are different when years in school and types of institutions attended are held constant.)

Table 3 displays the estimated proportions of these graduates who would have experienced debt burdens at $10,000 and other levels of borrowing in 1989. If the graduates had borrowed the "typical" $10,000, then 23 percent would have incurred debt burdens; that is, their annual payments would have represented at least 10 percent of their annual earnings. Over seven out of ten graduates with debt burdens would have been females, because females earn so much less than males. They also were five times as likely as males to have had no earnings. About 29 percent of Black graduates would have experienced debt burdens had they been trying to repay $10,000 in Stafford Loans, as their average earnings were less than those of White graduates, $22,420 versus $27,630.

The estimates in Table 3 indicate that debt burdens are more a function of graduates' earnings than amounts borrowed. For example, when loan indebtedness doubles, from $5,000 to $10,000, only 9.6 percent more of the graduates are added to the proportion with debt burdens, 23.0 percent versus 13.4 percent. When loan indebtedness triples, from $5,000 to $15,000, an additional 21.2 percent of the graduates would face debt burdens. In raw numbers of graduates, when loan indebtedness rises by 100 percent, from $5,000 to $10,000, the number of graduates with debt burdens grows by 72 percent. When loan indebtedness rises by 200 percent, from $5,000 to $15,000, the number of graduates with debt burdens grows by 158 percent.

These data have important implications for consideration of income-contingent loan proposals. First, loan indebtedness is not rising as fast as college costs, or as much as many believe. Second, the vast majority of undergraduates are unlikely to experience debt burdens under typical borrowing circumstances now, and within the next five years if loan debts grow as they have in Pennsylvania for the past five years. If the typical loan in five years is $12,500, matching the 25 percent growth of the past five years, then 27.8 percent of the graduates would experience debt burdens--if their incomes remained as they were in 1989. Even if all the graduates borrowed the maximum allowable for undergraduate study, $17,250, only 44 percent would have debt burdens, again if their incomes stayed at their 1989 levels. Over half the graduates, in 1989, could have afforded payments on at least $15,600 in Stafford Loans without incurring debt burdens.

Third, debt burdens are not evenly distributed among all graduates. Females, especially White females, are much more likely than others to have debt burdens, because many have no or relatively little earnings. Black graduates are more likely than White graduates to have debt burdens, because they earn less. There is no reason to expect these situations to change in the foreseeable future, as the gender-related and race-related differences in incomes have been with us for many years.

Because loan debts are not rising to levels that are burdensome for the majority of graduates, and because existing repayment burdens are not

Table 3
Estimated Proportions of Four-Year College Graduates Ages 25 to 34 Who In 1989 Would Have Had Debt Burdens In Repaying Stafford Loans, By Cumulative Loan Amounts

Amounts Borrowed	All Males	All Females	Total	White Males	White Females	Black Males	Black Females
$5,000	6.2%	20.3%	13.4%	4.8%	20.3%	15.4%	11.9%
$7,500	9.3	24.8	17.2	7.8	24.9	21.5	17.7
$10,000	13.8	31.7	23.0	12.0	31.3	30.0	28.5
$12,500	17.4	37.7	27.8	15.6	37.0	32.8	37.5
$15,000	23.0	45.6	34.6	20.6	45.1	40.9	42.6
$17,250	31.5	56.1	44.2	29.1	56.0	54.3	54.0

Percentages of All Borrowers With Burdens

Amounts Borrowed	All Males	All Females	Total	White Males	White Females	Black Males	Black Females
$5,000	22.4%	77.6%	100.0%	15.4%	67.5%	4.1%	3.5%
$7,500	26.1	73.6	100.0	19.2	64.3	4.4	4.1
$10,000	29.2	70.8	100.0	22.1	60.8	4.6	4.9
$12,500	30.4	69.6	100.0	23.8	59.1	4.2	5.4
$15,000	32.3	67.7	100.0	25.7	58.1	4.2	4.9
$17,250	34.7	65.2	100.0	28.0	56.5	4.4	4.9
All Grads	48.6%	51.4%	100.0%	42.5%	44.6%	3.6%	4.0%

distributed evenly among all student groups, offering income-contingent loan repayment programs to everyone may be unnecessary and unwise. Offering those students with debt burdens forbearance, deferments, graduated repayment schedules, and, in some cases, loan forgiveness, is a better alternative than requiring all borrowers to participate in an income-contingent loan program.

I am generally opposed to income-contingent loans. The first problem with them is that borrowers do not and cannot know how much it will cost to repay their loans when they accept them. If they cannot know this, then they cannot know how much their education will eventually cost them. If they cannot know what their education will actually cost, then they cannot make intelligent and informed "cost-benefit" analyses. They cannot assess the relative value of attending institutions of widely different costs, because they cannot compare the "net costs," that is, the costs after financial aid, of alternative choices.

Virtually all income-contingent loan programs allow, if not encourage, borrowers to incur larger debts than fixed-payment programs. Larger debts are made possible because payments frequently represent smaller proportions of borrowers' incomes upon graduation, when earnings are lower. But smaller loan payments made over many more years ultimately mean that the total payments for a given amount borrowed will be greater than the payments made for a fixed-payment loan at the same interest rates. It is impossible to escape the mathematics of the "PRT Equation" (Principal times Rate times Time) unless at some point Interest is foregone, a portion of the Principal is forgiven, or Time collapsed. When student loans cost more, then so does the education purchased with them, regardless of the fact that paying for the education is spread over many more years.

If larger loan amounts are available through an income-contingent loan program than a fixed-payment one, colleges may feel freer to raise their costs at higher rates than they have in recent years. After all, if most students are paying most of their costs through an income-contingent loan program and cannot calculate their true "net costs" of education, it is easier to raise the so-called "sticker price" for them.

The Self-Reliance Scholarship proposal addresses this issue by requiring institutions to justify cost increases that are greater than the increase in the higher education price index. But if all institutions spend more because they can raise tuitions to cover those expenditures, then all institutions' price indexes, and tuitions, will rise. Thus this provision of the bill becomes meaningless. Moreover, if more than half of an institution's students finance substantial portions of their costs through income-contingent loans, then costs to all students are more likely to rise. It is not difficult to envision situations in which institutions raise charges to all students in amounts that substantially reduce the purchasing power of other types of federal financial aid, such as Pell Grants and Supplemental Educational Opportunity Grants. Higher tuitions also mean a diminution in value of state grant and scholarship funds from private sources. Thus more students are forced into borrowing to pay for their education.

When the IDEA proposal was introduced in the Senate, I compared borrower costs to repay $10,000 in loans under IDEA and the Stafford Loan program. The first repayment problem with the IDEA proposal, and the Self-Reliance Scholarship proposal, is that interest accrues while borrowers are in school.

(The government pays the in-school interest under the Stafford Loan program.) Accruing interest at 8 percent per year on $10,000 borrowed at $2,500 per year for four years of undergraduate study results in borrowers leaving school owing $12,166 rather than $10,000, almost a 22 percent greater debt.

We know that all undergraduate borrowers won't be in school for four years, so not all would experience a 22 percent increase in indebtedness under IDEA and the SRS. However, considering their debt and the numbers of years they spent in school, the Pennsylvania undergraduates who entered repayment on Stafford Loans in FFY 1991 would have owed $383 million, rather than $322 million, if their loan interest had accrued while they were in school. That difference is about 19 percent. Therefore, it is safe to assume that borrowing nationwide under the IDEA and SRS proposals will very likely increase undergraduate debt levels by at least 15 percent even if students borrow the same amounts they borrowed under the Stafford Loan program. If the borrowers attend graduate school, their debts will increase even more dramatically, by at least 25 percent.

When Senators Simon and Durenburger released materials supporting IDEA, they identified four initial-year income levels to cover the majority of students: $9,750, $13,000, $26,000 and $36,000. I think these income levels are reasonably representative of the kinds of earnings undergraduates can expect when they leave school.

I assumed that all students would borrow $10,000. Using the IDEA formulas and assuming that all borrowers' incomes would grow by 5 percent per year during their repayment years, I found that those borrowers who start out earning $9,750 will make payments for 25 years totaling $27,288. This is 81 percent more than they would have paid for a $10,000 Stafford Loan. At the end of 25 years, these borrowers will still owe $14,650 on their principal plus interest. The government would forgive this amount, meaning that it would forgive about 46 percent more than the borrowers received for their education.

The borrowers who initially earn $13,000 would make payments for 25 years totaling $27,518, 83 percent more than they would have paid for Stafford Loans and nearly three times what they originally borrowed. And the government would have to forgive $9,218 in remaining principal and interest payments for these borrowers.

The borrowers who initially earn $26,000 repay $22,028, 46 percent more than they would have paid for Stafford Loans and more than twice what they originally borrowed. The more fortunate borrowers who initially earn $36,000 would repay $18,958, about 26 percent more than they would have paid for Stafford Loans. Figure One graphically illustrates the comparison of borrower costs for the four groups.

Figure Two is even more compelling, displaying the cumulative payments made and remaining balances on $10,000 after ten years of payments. At the end of ten years, the borrowers would have repaid their Stafford Loans with $15,052. The borrowers who initially earned only $9,750 will have paid $7,751 on IDEA loans at the end of ten years, but they would still owe more than the borrowers who had already paid their Stafford Loans in full. The situation for the borrowers who initially earn $13,000 is not much better. At the end of ten years they will have paid $9,131 but still owe $13,283.

Figure One

COMPARISON OF BORROWER REPAYMENT COSTS

GSL vs IDEA LOANS

($10,000 BORROWED)

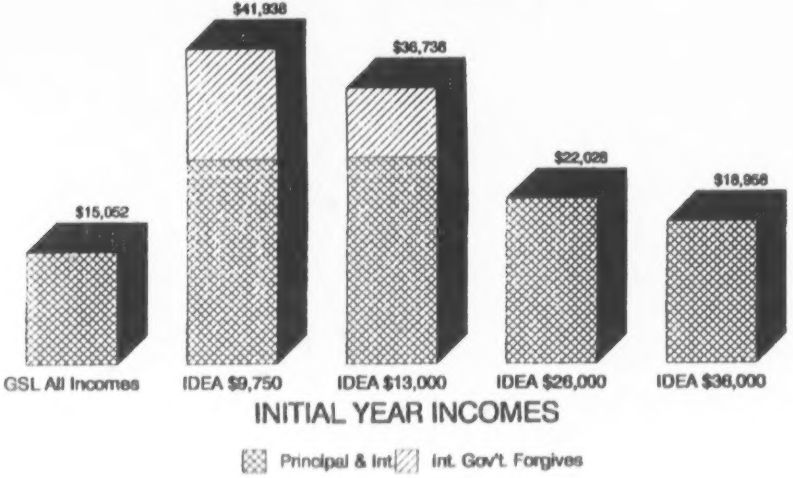
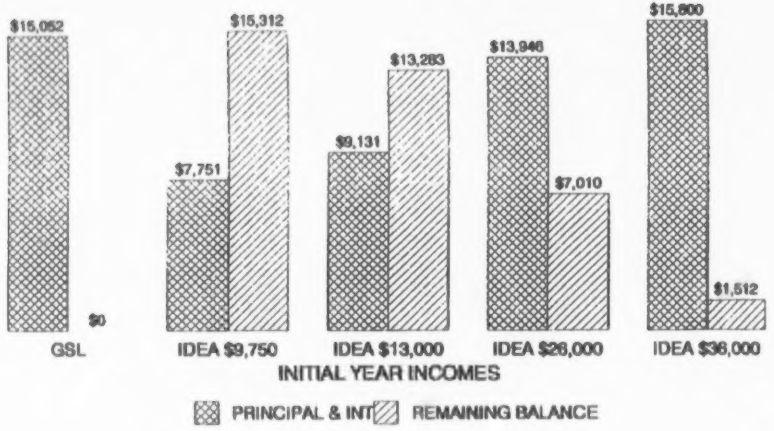


Figure Two

CUMULATIVE PAYMENTS MADE AND REMAINING
BALANCES ON $10,000 GSL AND IDEA LOANS
AFTER 10 YEARS OF PAYMENTS



The borrowers who initially earn $26,000 will have paid only 60 percent at much as they would have had to pay for Stafford Loans. But they would still owe $7,010, almost half as much as the Stafford Loan borrowers paid to fully pay off their loans. Finally, at the end of ten years, the borrowers who initially earn $36,000 will have paid only $748 more than the Stafford Loan borrowers. However, they will still owe $1,512 on their interest and principal.

Figure Three shows how cumulative payments for Stafford and IDEA loans would look over repayment periods of five, ten, fifteen, twenty and twenty-five years for the four borrower groups. At the end of five years, all four IDEA borrower groups will have paid less than they would have paid for Stafford Loans. But at the end of fifteen years, only the two lowest-income groups will have paid less on their IDEA loans than they would have for Stafford Loans. At 20 and 25 years, all four groups will have paid much more than they would have for Stafford Loans.

The repayment schedules proposed by the Self-Reliance Scholarship bill are different from IDEA's. But the borrowers will still have to pay more for their SRS loans than they would for Stafford Loans. SRS payments generally are to represent just 5 percent of the borrowers' gross annual incomes. However, there are exceptions. When the borrowers' incomes "are not more than 66 percent of the average gross income of individuals with college educations as determined by the Bureau of the Census from the most recent data available," then the annual payments will be 5 percent of that amount, even though an individual borrower's earnings may be substantially less than 66 percent of the average.

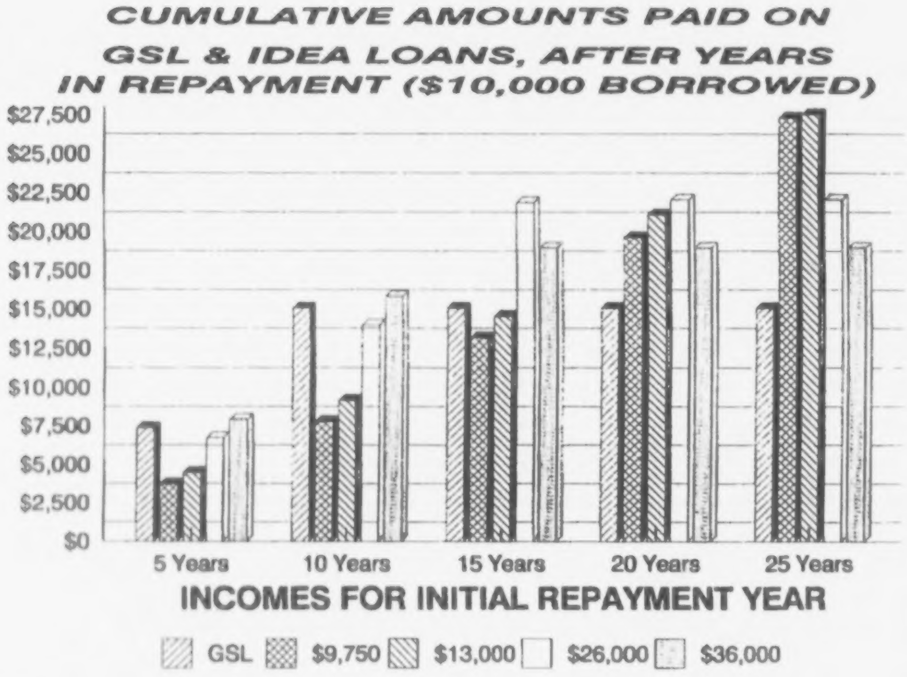
In 1989, the average income of all persons with four or more years of college was $36,038. This means that borrowers with incomes at or below $23,785 (66 percent of $36,038) will pay 5 percent of $23,785, or about $1,189 per year. This means that all borrowers with incomes below $23,785 will be paying more than 5 percent of their annual incomes. As we shall see below, there are likely to be many such borrowers.

The SRS bill has another exception to its general 5 percent-of-income repayment schedule. When borrowers' incomes are greater than 150 percent of the average income for college graduates, then their maximum payments cannot exceed 5 percent of that amount. Using the 1989 data, 150 percent is equal to about $54,057. Borrowers who earn more than this amount have to pay only 5 percent of $54,057, about $2,703 per year. This means that borrowers earning considerably more than $54,000 will pay less than 5 percent of their earnings. A proposal that requires financially handicapped borrowers to devote greater proportions of their earnings to loan payments than it requires of the most affluent borrowers is hardly in the spirit of traditional income-contingent loan plans.

Using the four initial-year income groups identified for IDEA loans, I calculated the costs of repaying $10,000 in loans under the Self-Reliance Scholarships program. The results are displayed in Table 4.

Four things in this table are noteworthy. First, all four borrower groups pay more for their SRS loans than they would pay for their Stafford Loans. Second, the SRS repayment schedule, like the IDEA schedule, requires the two lowest initial-income groups to pay more for their loans than it

Figure Three



CUMULATIVE AMOUNTS PAID ON GSL & IDEA LOANS, AFTER YEARS IN REPAYMENT ($10,000 BORROWED)

Table 4
Comparisons of Repayments for $10,000 In Stafford Loans and Self-Reliance Scholarships Loans, By Borrowers' Initial Year Incomes
FFY 1987 to FFY 1991

	All Stafford Borrowers	SRS $9,750	SRS $13,000	SRS $26,000	SRS $36,000
Borrowed	$10,000	$10,000	$10,000	$10,000	$10,000
Owed at Graduation	$10,000	$12,166	$12,166	$12,166	$12,166
Amount Repaid	$15,052	$21,100	$21,100	$20,030	$17,306
Years Repaid	10	14	14	12	9
SRS Pct of Earnings	--	11.1%	8.2%	4.8%	4.3%
Stafford Pct of Earnings	--	12.3%	9.2%	4.6%	3.3%

Note: All borrower incomes are assumed to grow by 5 percent per year. Percents of earnings represent loan payments as a proportion of earnings during years payments are made.

requires of the two highest income groups. Third, the proportions of earnings devoted to loan payments for the lower-income SRS borrowers will be only slightly less than the proportions they would devote to repaying Stafford Loans, and they will be paying for four additional years. Fourth, the two highest income SRS borrower groups have to use greater proportions of their earnings to amortize their SRS loans than they would Stafford Loans. The percentage differences here are admittedly slight, but they still are greater for SRS loans, another feature that should not occur in an income-contingent loan program purported to make loan payments less burdensome.

It is clear that borrowers with below-average earnings will pay more for IDEA and SRS loans, in absolute dollars and proportions of their incomes, than will their more affluent peers. In the Stafford Loan program, borrowers with below-average earnings pay the same as everyone. That lower-income borrowers pay more has different effects on different borrower groups. Because they will earn less, females will pay more for their loans than males. As Table 5 shows, they will also pay a greater percentage of their incomes for their loans. Note that over half the females would have had minimum SRS loan payments of more than 5 percent of their incomes. About one-third of the males would have experienced such a situation.

Minority group members will pay more for their loans than will White students. Borrowers who enter lower-paying professions, such as teaching, nursing or the ministry, will pay more for their IDEA and SRS loans than will borrowers who enter the higher-paying professions, such as business administration, engineering and law. Rather than reducing the disincentive to borrow when a student is considering a career in a lower-paying occupation, both proposals add to the disincentive and exacerbate the negative effects of education costs on choices of institutions, majors and future careers.

Some believe that income-contingent loans will solve the default problem. This is wishful thinking. Borrowers default on their loans primarily because they do not have enough money to make the loan payments. The education and training defaulters paid for with loans did not sufficiently enhance their ability to earn enough additional money to repay their loans. And this generalization applies at all levels of postsecondary education. When students borrow small amounts to pay for vocational training and no jobs are available or the available jobs have low salaries, they are very likely to default. When students borrow thousands of dollars to attend graduate school and their consequent earnings do not increase enough to cover the debt, they are likely to default.

Lending students money through income-contingent loan programs assumes that all borrowers will have incomes. As we saw in Table 2, 6.8 percent of four-year college graduates between ages 25 and 34 had no earnings in 1989 and another 16.2 percent earned under $12,500. Giving students income-contingent loans will not ensure that they have incomes, or incomes substantial enough to amortize their loans.

Income-contingent loan programs can help reduce borrowers' debt burdens when they experience lower earnings. But so can forbearances, deferments, and graduated repayment schedules offered through the current Guaranteed Student Loan Programs.

Defaults can be reduced another way in a fixed-repayment loan program, by simply extending the time borrowers can be delinquent before declaring the loan in default. When the period in which delinquent Stafford Loans had to be declared in default was extended from 120 days to 180 days a few years ago, the numbers of defaulters on loans guaranteed by PHEAA fell by one-third. This is because we had an additional two months to work with delinquent borrowers to bring their loans into good standing--and the borrowers had another two months to solve their financial difficulties.

The best way to reduce defaults is not through income-contingent loans, forbearance, deferments or extensions of delinquency periods, but is by assuring that the education and training paid for with loans is of the highest quality and enhances the student borrowers' ability to secure a good job with an adequate salary. A second better way to reduce defaults is to provide grants rather than loans to students who enter quality programs but have academic, socioeconomic or other disabilities likely to inhibit their success.

When students are "at-risk" there is no social justice in making them bear the majority of the risks of trying to improve their conditions through education paid for with loans when failure and consequent default on those loans leaves them worse off than had they not made the attempt in the first place. Persons who are responsible for providing education and financial aid to the nation's students should take to heart a primary tenet in the physician's code of ethics: "First do no harm."

In conclusion, let me briefly summarize my observations on the two income-contingent loan bills before you. The patterns of student borrowing and incomes after completing their education indicate that the majority of today's borrowers, and those of the near future, do not have loan debt burdens that will be solved by either proposal. Both income-contingent loan programs will increase students' costs of borrowing and, consequently, their education costs. Borrowers would have to pay more for IDEA or Self-Reliance Scholarship loans than they currently pay for Stafford Loans--much more. This is especially true for borrowers who are almost certain to earn less than their peers after graduation--women, minority students and those who pursue the lower-paying careers in our society. Finally, neither proposal reduces the costs to the government when students cannot repay their loans. It may be considered impossible to default on these income-contingent loans, but it is possible to not repay them. And failure to repay them will cost the government money.

Thank you for your attention to and consideration of my remarks this morning. I hope they have helped you.

SP3.48920204/01

Mr. **Miller**. Thank you, and thank you to all of the panels. I appreciate all of the testimony. I think it raises a number of issues with respect to the income-contingent programs that we have. I think it also raises many of those same issues that exist in the current system.

The education and the knowledge and the choice available to people as they seek loans is something that many of us have sought to improve, whether they're seeking a loan at a bank, or a student loan, or car loan, or credit card application, or what have you; we all would prefer to have better informed consumers of credit.

I think that's true of the current programs. The question of what kind of education we provide and what kind of opportunity they are buying with the loan goes to the current program. This committee has been saddled and this program has been saddled with one schlock operation after another that has sought nothing to do than to get that loan transferred from the student to the institution and abscond with it without leaving behind not only an education, but also an indebted student. I don't think that that's necessarily changed by these two programs.

I think also I would hope that the people would recognize that this universe is somewhat larger than some of the testimony was directed at. If I'm working at GWA today or I'm working at Macy's, I'm starting to think that I may have a year or 2 years time in which I may want to make a change in my career.

I also may not have the household income to go out and to immediately finance that education opportunity, whether it's a community college or training facility or to get an advanced degree in something I've already been trained in. I think that the income-contingent loan speaks to that issue somewhat better than the current programs.

The fact is, as we have witnessed over the last several years, millions of people who never thought they'd be in that situation, who have already completed a good portion of their education, now find that they may, in fact, have to acquire additional skills to move to another segment of our economy. It's keeping that in mind with this program.

The question of which arrow do you pick out of the quiver in terms of trying to finance that education is obviously one that that individual is going to have to make. I think it's important that we make sure that we put that financing in place so that they can in fact do that.

We all know that credit is very cruel to low income people. There's nothing friendly about a VISA card to a low-income person. But the low-income person may also understand that there may be no other way to acquire the necessity that they need other than to engage in that credit activity. If they pay it off over a longer period of time, they are going to pay more for that product than somebody who could walk in and pay cash.

That is a reality of the marketplace. Again, we go back and say we should try to educate people not to make that choice if they don't have to make that choice.

But I think, clearly, that we need a wider array of financing mechanisms for higher education so that people can make those choices. I take the criticism in the sincerest fashion. I think clearly neither Mr. Petri nor myself are suggesting this is the last word or this is the way this legislation should be passed, but I think that the intent is there.

Also, I worry that a person who makes the decision to engage in this loan activity and then to go through the education may find themselves, after they have finished 2 or 3 years of education, that this additional loan burden would be the deciding factor in the decision not to work.

There's something inconsistent about those two disciplines. To go through the discipline of completing your education, there's no question there's people who would do it, but to suggest that that's a major component and a problem with the program I think defies our historical experience as to why people default. They are unable, as you point out. They simply don't have the wherewithal to complete the payment.

Mr. Petri?

Mr. PETRI. Thank you, Mr. Chairman. I have all kinds of questions, and I'll try to restrict myself to just a few. I want to join you in thanking our panel for spending this time with us and for the effort that they put into preparing their testimony and studying the bills that are before us. We look forward to continuing to work with you.

Ms. Leyton, I appreciate what I thought was a qualified or maybe a wholehearted endorsement at least of one part of the IDEA bill, which is to give students the option of switching over to an income-contingent repayment of their existing Stafford Loans.

Mr. Landres and Ms. Leyton both, as students you're having to pay for education and a lot of other expenses, including coming to Washington and testifying, out of your own pocket. I know it's a great experience, so it's no doubt worth it. But in your case, Mr. Landres, I know you've come a couple of times because we've rescheduled these hearings. So, I'm glad that it has finally come to pass that you were able to present your testimony and did so quite ably.

I would like to give you an opportunity to respond to some of the comments that Mr. Davis made, particularly his assertion that IDEA would be unfair because it would require a longer repayment period than the current GSL programs.

We're not substituting one for another; we're simply presenting students with an additional choice. It's hard to understand how that could be unfair, but I wonder if I could ask which repayment structure students who you actually deal with would prefer, if they had to choose.

Mr. LANDRES. Well, I think that before I answer, I just want to express my appreciation again to you, and Mr. Miller, and Mr. Andrews for sticking with us this long to wait to hear from students. After all, we're the consumers in this proposal, and it's always nice to do a little market research before you go forward.

When I discussed with students their choices, basically the concerns that they felt were not against repaying more. I mean, nobody wants to pay more money. That's the bottom line. But with people seeing personal bankruptcy go up, we've seen credit card defaults go up, we're in a recession in which recovery is crippled by consumer debt and inability to pay back student debt. There is a fear of defaulting out there that is incredible.

People look at paying more longer as sort of an insurance bet. Nobody likes to do it, but when it's a choice, when it's not a forced option, when you can move into the income-contingent program at any time during your repayment, that really opens up the system for people that there isn't right now. The real point that needs to be made here is you're increasing access, you're increasing choice.

The IDEA plan would really make it possible for people to consider what they want to do. They have their Stafford Loans. They have their Perkins Loans, though that's less of an issue. They have their IDEA Loans. They really feel strongly that they want some kind of protection out there because it's a harsh world they're going into when they graduate. All bets are off as to income and as to success. If they have to pay a little more, they're willing to do it if it means that their credit ratings will stay good for as long as possible.

Mr. PETRI. Thank you. Mr. Hauptman, I had a couple of comments and questions. One is, so far as negative amortization is concerned, what's really wrong with negative amortization if you never have to pay the extra interest if you can't afford it? Why should people who live ordinary middle-class lives pay extra to subsidize someone who goofs off for 10 years or joins some Ashram in the Himalayas or whatever, and then goes to Wall Street and makes a lot of money?

Mr. HAUPTMAN. Well, there's two parts to the question. I think a lot of people would object to paying more for their loan to pay for somebody who goofs off and never ends up repaying it. So, that is the reason why I don't think the cross subsidy would be viewed favorably.

In terms of the negative amortization, what do you do with low income borrowers? I think there's a general predilection against the notion that what somebody borrows ends up growing over a period of time, and the fact that you're going to forgive it at the end of 20 or 25 years is a difficult point to sell.

I guess I would come back with the question: Why have the negative amortization? I think the answer is because we're trying to make the system self-financing. What I'm arguing is the cost of subsidizing those low income borrowers by not putting in negative amortization is not that high to incur the kinds of bad affects that would occur under it.

Mr. PETRI. Well, I guess the point of my question is that without negative amortization we're not only subsidizing low income borrowers; we're subsidizing conceivably very high income borrowers because people don't earn the same amounts every year of their lives. Someone may take a couple years off to have a lifetime experience and then go on and make big bucks, and they've got a subsidy for those low income years if you forgive rather than capitalize that interest.

So, my argument is that it's more just to forgive at the end of a long period of time rather than each year, since you have a lot of funny transfer payments if you do it on an annual basis.

Mr. HAUPTMAN. Valid point.

Mr. **Petri.** Maybe one or two other things. I've argued repeatedly that the in-school interest subsidy is regressive because those who stay in school the longest and, therefore, have the highest later incomes statistically, receive the most subsidy. Wouldn't it be better to decide whatever level of subsidy we want and then to distribute it progressively based on postschool income?

Mr. **Hauptman.** Well, I've written to that effect, so yes, I agree. One thing that might be helpful, which was surprising to me, was on this graph on page 6, the line for the Simon bill, I guess, but it would also be true for others if it were done this way, is not that much higher when you accrue interest of principal. It's surprising that the debt doesn't grow as much as we might suppose during the in-school period.

So, the other way to do it, which is something I would encourage the committee to think about at some point is, what about splitting the in-school interest subsidy between the Federal Government and the student; that is that you would accrue interest at, let's say, 4 percent, which would make for a much larger debt accumulation over a period of time, and the government would pick up the other half. I've also suggested why not split it between the school, the government and the student, but sometimes the schools don't like that.

In any case, the notion of splitting the in-school interest rather than having the Federal Government pay the whole thing, I think has a lot to be said for it.

Mr. **Petri.** The concern I have is that if you just have an even split, you tend to build in a subsidy, then, for higher income people. If you were to discount it for the first year of school, then the vocational school kids who probably have a lower income will get somewhat the same subsidy as——

Mr. **Hauptman.** That's another way of doing it.

Mr. **Petri.** There are a number of ways of looking at that. I think we should noodle over it a little bit.

Mr. **Hauptman.** It's just that 8 percent accumulates very quickly to a fairly large amount. So, if we could kind of lower that rate of accumulation, we might get a lot more students able to handle the accrual of interest.

Mr. **Petri.** Mr. Sears, thank you. Do you think the health professions students would choose to borrow from an income-dependent loan program rather than the HEAL program, given their different terms? Could you address the administrative burdens of the income-contingent program that we've been discussing here?

Mr. **Sears.** Yes. I think there are many attractive features to the income-sensitive proposal. I think yes, that many of our schools would be interested in pursuing that.

In terms of the administrative burden, I guess it's something that I've seen recently in the way of a study. It suggests that the administrative functions would drop from 63 to about 36 in a direct loan proposal. So, I guess I'm expecting and believing that that's going to simplify significantly the administrative burdens for schools.

Mr. **Petri.** Thank you. Mr. Davis, I wish I could thank you for your testimony, but I'm not sure I'm as happy with it as with some of the others. In any event, as best I can tell in reading it and trying to analyze it, we sort of have a fundamental analytical difference over how you account for the time value of money and whether a dollar today is worth the same as a dollar in 20 years, or whether you ought to discount future costs because there's a difference, and that you don't do.

Your analysis tends to, I think, distort or mislead the analysis because you're not really comparing similar values if you don't discount.

You give us an example on, I think, the middle of page 3, of a borrower who you say would have $14,650 forgiven at the end of 25 years. You claim it would have cost the government less to give the borrower $10,000 outright. Have you actually done the math on that? According to my calculation, the present value of $14,650 in 25 years, using the congressional budget office's discount rate of 7.7 percent, is $2,129, not $14,650.

When you consider all the payments that the borrower did make over the 25 years, then that present value is, according to our figure, a $1,201 subsidy. In contrast, the subsidy in the SLS program is 16 cents on the dollar or $1,600 on this $10,000 loan. So, even if all IDEA borrowers turn out to be low income, the cost to the government would actually be 25 percent less per loan than in the current SLS program, but that subsidy would go to low-income borrowers instead of to middlemen and to defaulters.

So, would you care to comment on that? Have I missed something?

Mr. DAVIS. What is an SLS borrower?

Mr. PETRI. Supplemental Loan Program. Well, let me just add that two paragraphs lower, on page 3, you talk about discounting. There you say if one discounts the present value of $10,000 originally borrowed, the government might be forgiving fewer real dollars at the end of 25 years than it originally loaned, but not much fewer.

Actually, it is much fewer because the net present value of that example would be a subsidy of about $650 according to our figures, if you discount it back. So, I think you're tending to magnify the size of the problem by not using the discounted value over time, which, really, students and borrowers have to do.

One other comment, you say that it's impossible for people to figure out how much they're going to owe because of income contingency, but they certainly can figure out the range and the buyout feature if their income should soar. So, if they're buying an insurance policy, they know what they're paying for that pretty definitely. It's not just totally uncertain at all.

There are defined parameters. You could not put an exact dollar figure on what it is, but you certainly could make the self-interest calculation and hit it pretty roughly; right? That's about the best we can do in life in most of the decisions that we make.

Mr. DAVIS. You think they could? See, I don't think an 18-year-old student can make a decision on an income-contingent loan because they don't know what the X is in the variable, their income. They have no notion of what that could be. I say this from a viewpoint of having been an admissions and financial aid officer.

I could recruit students like crazy with an income-contingent loan program because it would not—I would tell them it's not going to cost them a lot. It's going to cost you 1 percent of your income. It's for the rest of your life, but it's only 1 percent. They're not going to have any notion of what their income is going to be. Now, a person of our age, being a little bit more sophisticated, might be a little less easily swayed by this.

Mr. **Petri**. Maybe they shouldn't be allowed to choose which college they go to either, then.

Would you care to respond to that?

Mr. **Landres**. Yes. I would like, with the leave of the committee, to introduce my partner who is sitting right in the front row in the brown suit right over there. His name is Lee McAdams. He's also a sophomore at Columbia and he has a very high number of loans. I think I started talking to Lee about income-contingent loans a few days ago when we finalized the decision to come down here.

I don't know how much time he put in when he was first applying to college, looking at the various financial aid options, but it's my sense that he's a pretty good judge of what's best for him. I mean, he managed to choose Columbia. He managed to come up with a financial aid package that he's comfortable with.

I do resent the implication that 18 year olds who can fight and die for their country in the Persian Gulf can't make a decision about taking out student loans. We're required to make all sorts of judgments; where we're going to go, what we're going to eat, what we're going to study, what we're going to do. We might as well go to sort of a Soviet system where the government makes the decision of what you study, where you study, how much you make, where you live. We don't live in that kind of society. I think that we're perfectly capable of making our own choices.

Ms. **Leyton**. I'd also like to respond to that. In saying that it's important for students to be able to make a conscious choice to enter into this kind of program, we're not at all saying that students aren't prepared to make this kind of decision or that an 18 year old doesn't look at their options seriously and doesn't look at the costs of education and what benefits they will reap.

In addition, Mr. Miller's point is well taken, that many students today, including a number of the students that we represent are nontraditional students who aren't 18 years old, who are older students that are re-entering college. But there are a number of problems that students encounter when trying to make these decisions about what kinds of loans they're going to enter into.

They are often not notified of the full terms of the loans or they are presented with confusing answers about what their total debt will be, particularly with some of the uncertainty that revolves around a contingent loan repayment plan. Students don't know what their postgraduation income will be and have a definite right, given these economic times, to be very fearful of how much they'll be able to make after college.

So, students have a number of legitimate concerns which make income-contingent loan repayments very appealing. When we began discussing this with our board of directors and with students all over the country, people are very interested in looking at ways that loan program repayment can be more income sensitive. However, affordability of payments is not the only concern of today's students.

Students are also concerned about total loan debt. They are concerned about the length of time that they will have to repay their loans. Many of the students who are involved with USSA and who we've spoken to are very concerned that they can see themselves falling into a 25-year repayment plan because they are concerned about the postgraduation income, because it will be more affordable for them and enter into something that will leave them having to pay much more back and over a longer period of time.

That's not at all to say that those students made a poor decision, but it's to say that those choices should be made when students have the opportunity to have the full information and also when they know what their postgraduation income will be in a process that is much more conscious, such as through a petitioning process.

Mr. **Petri**. Thank you.

Mr. **Andrews**. [presiding] Thank you very much. I just want to conclude the hearing with a few questions. Before I do, I want to again thank Congressman Petri for his persistence in this idea. I think that at the end of this reauthorization the financial aid loan system is going to be fundamentally different than it was before it started. I hope it will be for the best, because I know a lot of people with good intentions are trying to make that happen.

In large part, that difference will be a result of your persistence and diligence in this issue. As a fellow member of the subcommittee, I appreciate all you've done and your inspiration for having today's hearing. I very much appreciate it. I also want to thank the last panel. We stayed because we know that the last panel is always the best panel. We all knew what the other guys were going to say, but you, ladies and gentlemen have distinctive points of view.

Mr. Landres, I appreciate the student point of view you present as to what choices and options are available. I thought it was very helpful.

Ms. Leyton, I'm particularly grateful that you created a distinction between the issue of where we raise the capital to run these programs and then how we collect the loans at the back end because those are distinctly different legislative and political issues.

Mr. Hauptman, I will refer to your chart on many an occasion. It is the most concise and comprehensive presentation of the varying proposals I've seen. I hope that we have your permission to share it with the other members on a regular basis because it's very helpful.

Mr. **Hauptman**. Surely, Mr. Chairman. The one caveat is that the proposals are changing from time to time. The way I characterize it, some of the proposals are no longer accurate.

Mr. **Andrews**. We understand that as far as today's date, but it is an extremely helpful way of organizing the issues and the answers.

Mr. Sears, you pointed out an issue that has particular import to those in medical education which I've heard about from people in my State as well. I hope that there is commitment on both sides of the aisle to address that as the reauthorization moves to the floor, to conference, and, hopefully, to enactment prior to the September 30th deadline.

Dr. Davis, I thought one excellent point in your presentation was that you've quantified a lot of the rhetorical conclusions people draw about the debt burden. It's very easy to oversimplify that issue. I found it instructive and, frankly, unique to be able to see your analysis laid out the way it was with respect to what incomes people are earning and how much they cost.

I want to come back to one point that you made about your arguments in opposition to income-sensitive repayment. I think it makes sense intuitively that——

Mr. Davis. I'm sorry. I am opposed to income-contingent loan repayments, not necessarily income-sensitive.

Mr. Andrews. Okay. I stand corrected. One of the arguments that you make in opposition to the ideas we're talking about this morning is whether or not the prototypical freshman borrower can make an informed decision about what to do. I take your comments, frankly, as saying that you're not casting any aspersions about the maturity or intellect of the decisionmaker; you're saying that the variables are not present to make an informed decision.

You could have the chair of Sallie Mae make these decisions, but that person may not have all the facts. I understand that.

Mr. Davis. I tried to imagine myself making the decision between buying two homes, two different priced homes, within an income-contingent mortgage. I pretty much know what my income stream is going to be like. A person who is 22 years old doesn't.

Mr. Andrews. That sort of leads to my question which is: can't we address that concern by moving the date of the election, as to what the repayment schedule would be, to after graduation when the person does have a sense of what he or she is going to make?

I mean, you can sign the note when you're a freshman, and then make an election 8 months, 9 months after graduation, when you've taken your job or you have a sense of what your income is going to be. Couldn't we address it that way, and also by providing for some reasonable number of changes during the repayment period?

If I get a raise—which, as a member of Congress, I certainly won't be getting in the near future, this being an election year—but if we get a raise, we have the opportunity to readjust our thinking and change the repayment schedule. Can't we address that problem that way?

Mr. Davis. It's possible, yes.

Mr. Andrews. Because it would strike me as being relatively simple administratively. It would require one more stop in the process of collection, I suppose. Before you begin repayment, you would make the election. Is there any reason why we shouldn't do that?

Mr. Davis. You would drive the people crazy who were servicing the loans. But other than that, that's no——

Mr. Andrews. We've probably done that to a fair extent already.

Mr. Davis. Right.

Mr. Andrews. It's really sort of analogous to what Congressman Petri said about making choices here. If you carry the thinking forward, that borrowers may not have all the data to make an intelligent choice and that they will wind up with larger debts through negative amortization or whatever, shouldn't we in the FHA home mortgage program mandate that people borrow for 15-year mortgages instead of 30? I mean, is that any different than the argument that you're making this morning?

Mr. **Davis**. I'm not sure. Your FHA repayments are not based on income-contingency, right, in their low income?

Mr. **Andrews**. That's correct.

Mr. **Davis**. And all you're doing is reducing their payments, their total payments, by making them every 15 years payout?

Mr. **Andrews**. It's always smarter to repay a mortgage in 15 years than 30. It costs less out of pocket. It's a Federally-guaranteed program. Why don't we mandate that?

Mr. **Davis**. In a student loan program?

Mr. **Andrews**. No, in FHA housing. I mean, doesn't the same rationale carry forward?

Mr. **Davis**. No, I don't think so. I'm not sure. I guess I'm missing the connection you're trying to make between home mortgages and student loans.

Mr. **Andrews**. Well, if I understand the argument correctly, it's that you have a concern, which I think is a very valid one, that borrowers who are at the beginning of their educational process, the 18-year-old prototypical borrower, who, by the way, isn't at all the prototypical borrower, as you well know, but that individual is not going to have the data about how much money he or she is going to make. I'm suggesting we can address that by letting that election take place when you generally know how much money you're going to make, after you've graduated and gotten a job.

Secondly, you're making the argument that—and correct me if I'm misphrasing it—people are going to be prone to make unwise choices. They are going to be prone to make choices that minimize their payments in the short run, but balloon the overall obligation over time. Well, the same argument would hold in the home mortgage program.

Mr. **Davis**. I don't think, in my testimony, I thought of the idea of making an unwise choice and borrowing more than they should. I think what my major concern was, as I was thinking about this and writing about it, was that the choices would be uninformed and that they wouldn't be able to consider, you know, the various alternatives between going to, say, a low-cost college versus a higher cost college.

My other concern when thinking about all this and writing about it is that with the income-contingent loan, it seemed to me that people whose education did not pay off to the extent that it pays off for other people, males versus females, would have to pay more through an income-contingent loan program, more in absolute dollars. Now, there's no way to keep females from paying more in proportion to their income unless you raise or somehow equalize females incomes. I'm concerned about that part of it.

The other thing that bothers me is that usually, if you look at—and I don't have a lot of information or data to support this contention, just some stuff that we did in Pennsylvania—but if you look at people who have lower earnings, they usually came from lower family backgrounds.

A Bachelor's degree doesn't level the playing field as far as incomes are concerned. So, not only did the person go through school financially handicapped, now he's graduated and you place a long-term handicap on him that is not equivalent to his more affluent peers. That's a thing that bothers me about these programs.

Mr. ANDREWS. The reference I was making is on page 3 of your written statement where you say virtually all income-contingent loan programs allow, if not encourage, borrowers to incur larger debts than fixed payment programs. Larger debts are made possible because payments frequently represent smaller proportions of borrower's incomes upon graduation when earnings are lower.

But, smaller loan payments made over many more years ultimately mean that the total payments for a given amount borrowed will be greater than the payments made for a fixed payment loan at the same interest rates. What I'm saying, what I think Congressman Petri was alluding to earlier, is shouldn't that be a choice that the individual borrower gets to make for himself or herself through the offering of the income-sensitive or income-contingent loan?

Mr. DAVIS. As opposed to a fixed loan or in parallel? You could make your choice one way or the other; right?

Mr. ANDREWS. Yes.

Mr. DAVIS. Sure. I don't have any problem with that. What I have is a problem substituting the income-contingent loan for another kind, for a fixed repayment loan.

Mr. ANDREWS. Would you support legislation that would give that option to the student between fixed payment and income sensitive, which is what the House bill looks like?

Mr. DAVIS. Assuming that the student would be told the kinds of things that he is told when he enters what we call the entrance interviews, when you accept your Stafford Loans. Assuming that the student has a chance to make an informed choice. He has some notion of what income streams are going to be like in the future, some notion of what choices of jobs are going to be, and things like that.

Mr. ANDREWS. I appreciate that. I think the way we could accomplish that would be, as I say, move that election date later in the process when the person is graduated and has an idea of what his or her income will be. With that modification, I think it would work.

Mr. Hauptman, did you want to comment?

Mr. HAUPTMAN. Yes. Thank you, Mr. Andrews. Absolutely moving the point of decision from the time of the loan to the point of when the repayment starts is the whole point behind the flexible payment option that I was talking about. The question back to you would be: What options are you providing to the borrower at the time when repayment starts?

If I take your last comment, you would offer them an option between amortized payments or regular payment or some sort of graduated or income-contingent, according to negotiation between whoever has the loan at that point. That's exactly what I was trying to say.

The one point I would add to your comment, though, if you do that and the bank still holds the loan, that increases the cost to the government of taking the election other than the 10-year straight repayment.

Mr. **Andrews**. Do you have any suggestions as to how we can see that the banks don't hold the loans?

Mr. **Hauptman**. Yes. There should be another agency involved which is responsible for doing income-contingent repayment. I would not make it the IRS. I would make it the State guarantee agencies who do not require a special allowance payment in order to do business, unlike the banks.

So, in other words, if a student came in and the point of repayment starts and says, "I need help. My debt is too much for my income," then the set of loans that that student holds would be sold or bought by the guarantee agency and then an alternative repayment schedule extended, graduated income base, whichever, would then be set up for that student. The government at that point has no additional cost involved with it. So, that would be my only thing.

Mr. **Andrews**. I appreciate that. The House bill in its present form would not mandate but would permit exactly that scenario. It would permit the Department of Education to contract with the State guarantee agency to perform precisely that function. It's one of the reasons why the House bill tries to be broad in its administrative options.

Does anyone else have a comment, and then we'll close? Yes, sir?

Mr. **Landres**. I think that, to sort of summarize and put into perspective the exchange that just went on, we need—and I believe that the committee has done in its bill—a much greater effort at disseminating information upon application; that information needs to be provided to students on a whole range of issues on student aid; that we can make a much better decision about our options the more information we have.

The other thing that I wanted to point out, we're talking about this repayment plan as if everybody who goes in is going to be paying back for 25 years. That's not true. According to my reading of the bill, most people are going to take 10 to 12 to 15, maybe 17, years to repay. That's not the same thing as 25, and the interest rate and the payments are much less.

The final thing that I wanted to say was that I think moving the choice date is something that we should look at very, very seriously. Maybe there could be some consultations with Mr. Petri and the committee and the guarantee agencies, such that one has the option of taking a Petri Loan, which would be just like a Stafford Loan except amortized at this variable interest rate——

Mr. **Andrews**. We prefer to think of them as Ford Loans.

Mr. **Landres**. Okay. Maybe we could give it a bipartisan name. But at some point during that amortization process, during that repayment process, if a student says, "I want out. I want income contingent," they can do that. So, it drops down at income contingent at any elected point.

Mr. **Andrews**. Thank you.

Mr. Chairman, did you want to comment?

Chairman **Ford**. It just occurred to me that we could reach Mr. Hauptman's concern. There's never been any necessity for it before because the conditions were rigid, fixed, and there were no alternatives available to students. We have a law in the books that we've worked with for a good many years called the Truth in Lending Law.

When young people go to buy a home, for example, they have to have presented to them a truth in lending statement that describes all of the characteristics of the instrument they are about to sign called a mortgage, including a table that shows them how much they're going to repay if they pay only at the rate required by the mortgage over a period of years. It's a very sobering experience for people to find out what they really pay for a $50,000 home mortgage over its life.

If we were going to give these options, it occurs to me that it would be rather simple to simply make it clear that everybody, no matter whether it's done at the State agency or any place else, would be subject to the terms of the Truth in Lending Act so that at the point of the decisionmaking, the maximum amount of information that you can project would be out there.

When the student makes the choice, they've got the maximum amount of information before them.

One of the reasons we cut out several of the student deferments is because students told us that they are meaningless because so few of the students understand them. So we made them very simple.

The second thought that comes to me as I listen to this exchange is I'm presupposing that if I, for example, came out of law school and thought that I might like to work for worthy causes for a period of time, I would choose the lowest initial payout that I could get. But that still would not foreclose me if I stumbled into a windfall along the way of advancing the payoff time on my note.

We don't write these notes like fixed mortgages that penalize people for early repayment. It's got a flexibility in the direction of shortening the time, if you're able to do so. So, you can save that tremendous payout. If they are properly informed at the beginning, they will be motivated to do that as soon as possible.

Amongst my contemporaries, when I started practicing law, was a commonly discussed phenomenon that the first time you happen to hit a case where you weren't working for the good of God and your country but for a real fee, you finally paid off all the debts you'd been accumulating in school and while you started your practice. If you were lucky enough to have that happen early enough in your practice, then you could take off like a big bird. But it was clearly understood it's hard to project where your income stream is going to go.

Now, I heard, just before I had to go to this little meeting out there, Mr. Landres saying that the students—you mentioned Columbia?

Mr. **Landres**. Yes.

Chairman **Ford**. Students in Columbia are like other Americans at the moment. They don't know what's going to be out there when they get out of school next year or 2 years from now, because for the first time in many years, there's a genuine concern that a college educated person who is not just a bearer of a certificate, but actually an educated person, may have trouble finding a job for a while. So, the choices that they make, even while in school, may not be appropriate to the way they're going to live the rest of their life.

I can't see how anyone could claim that it would cost us more money to defer the choice of whatever options we end up with until the period when you're going to go into repayment rather than at some earlier period. I don't see how it advantages anybody in the lending stream to tell them early when you sign the note how you're going to pay it back when they suffer no penalty no matter what your decision.

The difficulty, however, is you have to extend the interest subsidies for this extended time if we're talking about Stafford Loans. If we're talking about Andrews Loans, we don't have to worry about it because it's Federal Government. Mr. Chairman, it occurs to me that in an indirect way these people are telling us that the really best way to go is with your direct loan program.

Thank you very much for letting me butt in.

Mr. ANDREWS. You're welcome anytime, sir. Do we have anything else?

[No response.]

Mr. ANDREWS. Now, before we adjourn, we do have some statements to be entered into the record; the statement of Elizabeth M. Hicks of Harvard University, the statement of Senator Joseph Lieberman; the statement of the Coalition of Higher Education Assistance Organizations; the statement of Senator Dave Durenberger; the statement of our colleague Congressman Joe Gaydos; the statement of John Schullo from Bemidji State University in Minnesota; the statement of Professor Barry Bluestone; and the statement of Charles B. Saunders, Jr., from the American Council of Education. Without objection, they will be entered on the record.

With that, we stand adjourned.

[Whereupon, at 1 p.m., the subcommittee was adjourned.]

[Additional material submitted for the record follows.]

BACK TO THE FUTURE; MAKING THE CASE FOR DIRECT LENDING

Presented by

ELIZABETH M. HICKS
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before the

ANNUAL MEETING AND STUDENT LOAN SEMINAR

OF THE

COALITION OF HIGHER EDUCATION ASSISTANCE ORGANIZATIONS

January 28, 1992

BACK TO THE FUTURE: MAKING THE CASE FOR DIRECT LENDING

I. INTRODUCTION

One of the most controversial debates during the current reauthorization is whether the federal government should move from a guarantee student loan program to a direct loan program. Without a careful review of direct lending, there is a temptation to assume that it is either a return to a past failure or a risky experiment for the future.

Nothing could be further from the truth. Direct lending is neither the rebirth of a prior program that failed, nor is it a major innovation yet untried. Rather, direct lending is the application of successful components of several past financial aid programs to the present environment, with the goal of ensuring the perpetuity of our largest federal student financial aid program well into the future.

The purpose of my presentation is to explain how direct lending will take us "Back to the Future". After a brief background of the Guaranteed Student Loan program, I will highlight the benchmarks of an ideal student loan program and explain why direct lending meets those standards. We will examine how direct lending works and conclude by exploring what the future holds. Throughout, my basic premise is that a guarantee loan program is outdated and a direct loan program timeless.

II. BACKGROUND

The fundamental concept of the Guaranteed Student Loan program -- whereby federal expenditures are leveraged to generate private capital -- has changed very little from its beginnings in the mid-1960's. What has changed is the nature of the students and families the GSL program serves and the environment in which the program operates.

* **Originally directed to middle-income families experiencing cash flow problems**, the GSL program now is used to meet the **demonstrated financial need of federal student aid applicants from low- and middle-income backgrounds**.

* **Initially serving students at a few public and private institutions**, the GSL program now serves **students enrolled in thousands of institutions from all sectors of postsecondary education**.

* Formerly a program used to award the **last dollars** for student's educational costs, the GSL program now is used to distribute the **first dollars** for students' direct educational and living

expenses.

- In the beginning a program that awarded millions of dollars annually to students, the GSL program now awards billions of dollars each year.

These changes have stretched the limits of the GSL program too far. The program was originally designed to operate on a smaller scale. A student borrowed all his loans from the family's neighborhood bank and the lender held and serviced the borrower's entire loan portfolio throughout the life of the loans.

But economies of scale have rendered this personal approach impractical, if not impossible. Lenders now have no prior banking relationship with the borrower, conduct most of their business with the borrower by mail, offer 24 hour loan processing in order to compete, contract out loan servicing, and sell loans as needed to secure capital -- sometimes even before the loan is disbursed, and often without informing the borrower.

In addition to the student, the school, the lender, and the federal government, this private-federal partnership now includes the guarantee agency, the servicer, the secondary market, and the collection agency. Further, since the original design of the GSL program did not take into account a growth industry of servicers, there is less oversight of these entities, which has recently resulted in improper servicing of millions of dollars worth of loans.

The GSL program carries with it the seeds of its own destruction. It is an inappropriate structure in the present environment because it directs limited federal dollars to the burgeoning administrative bureaucracies required to support the program, rather than to students in need of funds for their educational expenses.

During the past year, many federal legislators, educational associations, and educational institutions have concluded that simply changing the current GSL program will not address its multitude of problems. The next logical progression -- to restructure the program -- is necessary. With this thought in mind, several proposals have been developed to create an ideal student loan program.

III. THE IDEAL STUDENT LOAN PROGRAM

The ideal student loan program serves the needs of the borrowers for whom it is intended, results in the most effective expenditure of the lender's funds, and provides reasonable assurances that the funds will be repaid. The benchmarks I have identified for the ideal student loan program can be summarized as follows. The ideal student loan program:

- is responsive to the needs of the borrower
- is understandable to the borrower
- is administratively manageable and effective
- keeps administrative costs to a minimum
- ensures program accountability and integrity
- provides assurance for capital demands
- is equitably available to all potential borrowers
- has beneficial terms for borrowers
- protects the rights of the lenders
- results in timely delivery of the loan proceeds

A careful evaluation -- by those in the best position to make such judgments-- of these, and similar value descriptions, against the current GSL structure indicates the program is in need of change. At its November 1991 Board of Directors meeting, NASFAA did not fully endorse current federal direct loan proposals, but recommended development and implementation of a parallel direct loan program, with no limitations on the number of schools that could participate. In a letter to the NASFAA membership, Dallas Martin, the President, shared the Board's evaluation of the current GSL program against their ideal student loan "value descriptions". The letter states:

> Generally speaking, there was nearly unanimous agreement that the existing GSL program has a number of deficiencies that need to be addressed to make the program more understandable and responsive to students, to improve administrative efficiency, and to ensure program integrity, The Board particularly favored proposals which would standardize application, deferment, and reporting documents and efforts to reduce origination fees and administrative complexity for students. Many Board members expressed genuine frustration with the time delays and difficulty they experience in providing quality service to student borrowers under the current structure.

On the other hand, direct lending fared quite well when the NASFAA Board of Directors measured it against their value descriptions. The letter continues:

For these reasons, many members favored the direct lending proposals, believing that institutions could originate loans, disburse funds, and make needed adjustment much more effectively and without the delays and inconvenience that now occurs at many schools. Further, the idea of reducing the number of entities that students must deal with to initially secure their loans was seen as a very positive feature of the direct lending proposals. A majority of Board members also strongly favored the House direct lending approach which would eliminate student insurance and origination fees.

IV. HOW DIRECT LENDING WORKS

Some of the most adamant critics of direct lending are those that make erroneous assumptions about the program and how it will operate. One incorrect assumption is that direct lending is the Guaranteed Student Loan program with the school as the lender -- that is, something akin to the previous Federally Insured Student Loan program. A direct loan program would be more similar in concept to the Pell Grant program, or the Perkins Loan program, with some notable differences.

In order to comprehend how direct lending works, it is important to understand the similarities and differences of direct lending with the Guaranteed Student Loan program, the Perkins Loan program, and the Pell Grant program.

A Comparison of Direct Loans and the Guaranteed Student Loan Program

A Direct Loan program and the Guaranteed Student Loan program **share** the following features **as both**:

- Are an entitlement program.
- Have no limit on the amount of capital.
- Have capital availability determined by student and parent eligibility only.
- Have eligibility for subsidized loans based on financial need.

Direct lending **differs** from the Guaranteed Student Loan program as **under direct lending:**

- The capital is secured at wholesale, rather than retail, rates.

- The program is financed through the sale of government securities, not through commercial lenders.
- Government subsidizes are targeted to students, not to the administrative bureaucracies required to support the program.
- The multiplicity of guarantee agency policies and procedures is eliminated.
- The process is transparent to the student.
- The resolution of overawards and refunds is more easily facilitated.

A Comparison of Direct Loans and the Perkins Loan Program

A Direct Loan program and the Perkins Loan program **share** the following features as **under both**:

- There is no need for the borrower to complete a separate loan application in addition to the federal student financial aid application.
- The school is able to disburse and deliver the loan along with the rest of the student's financial aid package.
- Schools have direct control over the timing and distribution of loan funds.
- The school secures the student's properly endorsed signature on a standardized promissory note.

Direct lending **differs** from the Perkins Loan program as **under direct lending**:

- There is no limit to the amount of capital.
- Schools are not required to submit an institutional application to secure a level of funding.
- Schools are not the lenders and never own the loans.
- Schools are not responsible for the servicing and collection of loans, or for contracting these services.
- Schools are not required to provide long-term storage of promissory notes, but rather transmit signed promissory notes to the school's designated servicing contractor.

A Comparison of Direct Loans and the Pell Grant Program

A Direct Loan program and the Pell Grant Program share the following features as under both:

- At the beginning of each award year a school is given an initial authorization, which is adjusted as the award year progresses based on the actual number of eligible students.
- A school draws down funds from the Department of Education's Payment Management System.

Direct lending differs from the Pell Grant program as under direct lending:

- There is no limit on the amount of capital.
- Receipt of funds is not dependent on the submission of a separate voucher for each student, such as the Pell Grant Student Aid Report.

Ten Basic Steps to Apply for and Receive a Direct Loan

Here are the ten basic steps involved in applying for and receiving a direct loan:

Step 1 A student completes a federal financial aid application to apply for all forms of Title IV aid. There is no additional application for a direct loan.

Step 2 The student submits the application to a processor.

Step 3 The processor computes a student's eligibility according to the federal need analysis and conducts central data base matches with entities such as Selective Service, the Immigration and Naturalization Service, the Department of Justice, and the National Student Aid data base.

Step 4 The processor forwards its result, including default analysis, to the school.

Step 5 The school reviews the need analysis, determines the student's eligibility for all forms of Title IV aid, and sends the student an award notice.

Step 6 The school secures the student's signature on a standardized promissory note and ensures that the note is properly executed.

Step 7 The school draws down the funds from the Department of Education's Payment Management System and posts the funds to the student's account within time frames consistent with existing procedures.

Step 8 The school conducts entrance loan interviews with new borrowers. A school can credit a new borrower's account, but cannot advance loan proceeds to a new borrower prior to the completion of the entrance loan interview.

Step 9 The school transmits the promissory note to the Department of Education's servicing contractor.

Step 10 The school originally reports essential data elements to the Department of Education's contractor such as: enrollment status and amount of loan. The school also updates this information with the contractor as necessary, based on change in enrollment status or amount of loan disbursed, including refunds and overpayments.

V. EXPLORING THE FUTURE

The future holds the possibility of either failure or success, depending on the path we choose.

If we continue on our present course with the Guaranteed Student Loan program, we will end up spending more to make loans to fewer students. To bring escalating default costs under control, Congress and the Department of Education will continue to micro-manage the program. There will be little or no possibility of performance bonuses for those entities that administer the program effectively.

I agree that we could improve the current GSL structure by standardizing policies, procedures, and forms and by making better and common use of new technologies. And I hope that you would agree that, to date, lenders, guarantee agencies, secondary markets, and servicers have failed to do this on their own initiative.

I also agree that the creation of the National Student Aid Data base would be of the same benefit to the GSL program as it will be to direct lending.

But, I also believe that the centralization that would occur under direct lending -- which is the same as that under the Perkins Loan program -- will lead to a faster and smoother transition to this standardization. In addition, the creation of direct lending will provide the needed incentive to make the completion of the National Student Aid Data base a top priority.

In the final analysis, the one irrefutable fact is that the current GSL program will cost more than direct lending because it obtains

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capital at retail, rather than wholesale, rates. If you do not believe me, ask any child old enough to understand the concept of borrowing and interest whether he would want to borrow a loan at x interest rate, or x interest rate plus 3.25%. Without the cost savings direct lending produces, the future of our largest federal student loan program is not bright.

VI. CONCLUSION

I began this presentation on the merits of direct lending with the "Back to the Future" analogy. For those of who you are not movie buffs, or did not see "Back to the Future I, II, or III", you may be unfamiliar with the plot of this science fiction trilogy and the struggle of the protagonist which is central to all three films.

The plot is straightforward. A successful time machine is invented which provides the protagonist with an opportunity to travel at random from the present, into the past, on to the future, and back again. Knowing exactly what the future holds, the protagonist struggles with whether he should change the course of destiny by effecting the outcome of critical events.

I am not trying to portray these movies as deep philosophical works of art. They were simply made to be entertaining, and they are. I am using this analogy in the hopes that if I leave you with only **one message** it is the following.

We do not need to travel into the future to know that **direct loans will result in considerable cost savings**. Responsible analysts in the Congressional Budget Office, the General Accounting Office, and the Department of Education have told us so. We do not need to travel into the future to know that **schools can, and will, more effectively originate loans than commercial lenders**. Our past experience with the Perkins Loan program proves that. We do not need to travel into the future to know that **direct loans will better serve borrowers**. Confused, and often desperate students and their families, are telling us now that they need a simple and understandable program.

Unfortunately, we are at a point in time when the current GSL program is beginning to show the signs of serious systemic problems. But fortunately, we are also at a point in time where a number of events are converging that make direct lending a possibility. Recent international events, as well as the credit reform act, provide us with an opportunity to reprioritize our federal spending and invest funds in our nation's youth. We have several members in both the House and Senate who have shown the vision and leadership to promote creative direct lending proposals. We have universities and colleges that are willing, on behalf of their students, to commit time and energy to help make direct lending a success.

As the protagonist in "Back to the Future", we have the ability to change the course of destiny -- in our case, by replacing the federal guarantee loan program with a federal direct lending program. If we do not intervene, but rather continue on our present course, we will endanger our largest federal student financial aid program. But more importantly, we will risk access to higher education for the very individuals who must be in the forefront of our future efforts to remain among the world's leading nations. We cannot let this moment of opportunity escape, for -- unlike the protagonist in "Back to the Future" -- we are not in a time machine and will never pass this way again. Thank you.

11-14-91

SENATOR JOSEPH I. LIEBERMAN
TESTIMONY BEFORE THE SUBCOMMITTEE ON POSTSECONDARY EDUCATION
COMMITTEE ON EDUCATION AND LABOR
NOVEMBER 14, 1991

Mr. Chairman, I am pleased to have this opportunity to testify in support of the concept of self-reliance scholarships which would enable students to borrow money for tuition and pay it back as a fixed percentage of their income. Over the past several months I have been traveling around Connecticut speaking to my constituents about their financial concerns and what I hear again and again is the fear that they will not be able to afford to send their children to college. In fact, as tuitions continue to rise and student aid becomes increasingly more difficult to get, fewer and fewer Americans can afford to send their children to our many good colleges and universities.

Middle-income families find themselves between a rock and a hard place. With the average cost of tuition at a private university now over to $16,000 a year, they can't afford to pay the tuition, yet they make too much money to qualify for grants or loans. Every year the cost of higher education takes a bigger and bigger bite out of a family's income. In 1970 the average family could send a child to college for less than 28% of their annual income, now college costs 38% of what they make each year. College is fast becoming a luxury many Americans cannot afford.

But college is not a luxury for the American economy. We, as a society, cannot afford to deny so many of our young people the opportunity for a college education. In an increasingly competitive, global economy, America needs more, not fewer, educated workers. We must develop programs to provide as many students as possible the opportunity to pursue higher education.

I am pleased to be working with Senator Bradley on S. 1562, legislation to implement the Self-Reliance Scholarship program. This program will make more funds available to students for college and graduate school, while making it easier for them to repay their loans after they graduate, and much more difficult for them to default.

Millions of American families will have access to this program without having to fill out complicated financial disclosure forms, and without having to determine the value of their home and their other assets. This program will provide middle-income families with access to student loans, allowing many more students to pursue the dream of a college education.

The hallmark of this new student loan program is the repayment plan. Students can choose to repay the loan over a 10, 15 or 25 year period and depending on the time period will pay it back as a percentage of their income ranging from 1 and 5%. The owed amount will be automatically collected by the IRS. Defaults will be dramatically curtailed because of the IRS collection and because the amounts being paid will fairly reflect the graduate's earnings. Teachers will not have to move to Wall Street because they cannot afford their student loan bills; doctors will not have to opt for private practice rather than working in a community health center.

The Self-Reliance Scholarship Program will also enable adults with families to return to school to complete their education or upgrade their skills. It is difficult for adults to return to school because they have families to support and mortgages to pay. By providing them with access to funds and a loan repayment schedule which is tailored to their income level, this program should allow them to return to the classroom and improve their ability to compete in today's job market.

We cannot afford to become a society where only the rich are able to attend college. Everyone in this nation, no matter what their income level, should have the opportunity to pursue an education. An educated population is the most critical factor in enabling this country to succeed in a competitive international market. The Self-Reliance Scholarship program will assist all students attending school. The recent high school graduate whose parents cannot afford tuition, the single mother struggling to support a family and get an education, the forty-year old worker who needs to update his skills in order to remain in the workforce, all will benefit from this program. And so will our country.

Mr. Chairman, I thank you for holding this hearing and I look forward to working with my colleagues in the House and Senate to enact of program of this kind before the end of this Congress.

Postsecondary Education Hearing
February 6, 1992
Joseph M. Gaydos

Mr. Chairman, I can understand the attraction of implementing an income contingent loan repayment system for students borrowing under the Higher Education Act of 1965 because it seems so simple on the surface. Graduates who have high salaries would fully repay their loans quickly and graduates who consistently earn low wages may never fully repay their loans.

As I said, this concept may appear very simple and very fair in theory, but I have some severe reservations about fully embracing this type of repayment plan. Aside from my concerns about how effectively an income contingent loan program would be implemented and managed, I have concerns about whether tying loan repayment to future earnings will truly treat students in a fair and equitable manner.

For the past several years students at ten institutions have been participating in an income contingent loan program. So far, to my knowledge, there is no reliable empirical evidence that this type of loan repayment is beneficial for students. At the same time, there seems to be some indication that we should not adopt this type of repayment plan for all student loans or even allow the original ten institutions to continue making loans with this type of repayment obligation.

The terms of income contingent programs usually require that the interest on loans be capitalized each year -- even while students are in school. This causes those students who must borrow heavily to finance their educations and don't earn high wages after graduation, to pay an enormous amount of interest every year without substantially reducing their overall levels of debt because the outstanding principal is repaid very slowly.

In some of the income contingent loan proposals this situation is supposedly "dealt with" by dismissing students' loan obligations after a certain number of years -- usually 20 or 25.

I don't believe this approach is "dealing" with the situation. It seems that for many low-wage-earning graduates the burden of paying high interest without repaying a sufficient amount of the outstanding principal each year may force them into the position of putting their lives on hold for 20 to 25 years while they are virtually held hostage by their educational debt.

I'm looking forward to hearing how our witnesses feel about this issue and would especially like to welcome a fellow Pennsylvanian, Jerry Davis, Vice President for Research and Policy Analysis at the Pennsylvania Higher Education Assistance Agency.

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Testimony by John Schullo, Director of Financial Aid, Bemidji State University, Bemidji, Minnesota 56601-2699 for the House Subcommittee on Postsecondary Education, in support of H.R. 2336, the "Income-Dependent Education Assistance Act of 1991."

Bemidji State University is a small State University of 5,400 students located in Northern Minnesota. We are one of the smaller universities comprising the seven institutions which make up the Minnesota State University System of 65,000 students. Our institution is located within forty miles of three major Indian Reservations. Many of our students are high need students from low income families...and in case you are wondering, our cohort default rate on the Stafford Loan Program is 4.8% and our default rate on the Perkins Loan Program is 3.91%. Our students pay back their obligations.

Reauthorization is always an exciting time for the financial aid community. I find myself asking, "Are they going to get it right this time?" My financial aid career began in 1966 as a direct result of the Higher Education Act of 1965. I have, for many years, observed and eagerly anticipated each Amendment and Reauthorization of that brilliant original piece of legislation. Again, in 1991 I find myself asking, "Are they going to get it right this time?"

Many of the new proposals surfacing as a result of the Reauthorization process are right on target. A single need analysis, a free application, direct loans, simplification, etc., are examples which demonstrate to me and to students that Congress is moving in the right direction.

It is evident to me in reviewing H.R. 2336, the "Income-Dependent Education Assistance Act of 1991," that someone in Washington must be receiving calls from the same mother I am. I call her "Mother-of-the-Smoking-Phone." She has been calling me for 25 years. I would like her to stop calling me. I sincerely hope you get it right this time.

Getting it right will require a complete revamping of the federal student loan programs. We know how complex it is to determine eligibility and continually adjust loans for potential and actual overawards. When we should be spending our time processing applications for financial aid and establishing awards for needy students, we find ourselves involved with lenders and guarantee agencies, receipting checks, cancelling and revising checks for withdrawing students or changes in enrollment and in attempting to resolve the increasingly burdensome task of clearing students who have been determined to be in default because of a missing form. We know the cost to students in terms of confusion, delays and emotional stress. We know, too, that the more agencies involved between the funds and the student, the more confused students become and the more problems they encounter. The process has become tremendously complex involving many outside agencies each with their own priority agenda. It is indeed time to get it right this time.

Toward getting it right, a direct student loan proposal is not only right on target...it hits the bulls-eye. In addition, the IDEA plan addresses default and repayment problems in a unique and realistic manner. The Income-Dependent Education Assistance Act proposed by Representative Thomas Petri provides answers to the very real awarding, delivery and repayment problems inherent in the present student loan borrowing system.

I want to mention only three things about the Petri proposal. They concern three very real frustrations people have with financial aid and how these frustrations are resolved by this direct loan proposal.

First, students feel caught in a government sting operation with regard to loans. They must take them to remain in school. No loan, no school. They know that the future is uncertain. For some, the odds are against their repaying their loans in a timely manner. The economy, the geographic region, the family history, crime rates, divorce rates, personality of the borrower, low wages of entry level positions...many factors enter into student default rates. Because of factors such as these, the current Guaranteed Student Loan programs guarantee defaults for a large segment of the borrowing population.

My point is that any loan program which uses as collateral the academic progress and potential earnings of the borrower, must either accept a high default rate on those loans or establish a method of addressing the default problem which is not to the detriment of the borrower. To put it another way, some students have a choice...loan or no school. When they graduate or leave school, they have a choice...pay or default. When real life problems occur, including necessary consumer purchases such as a refrigerator or automobile, the choice often becomes one of survival or default.

The IDEA repayment plan provides exactly what students need...a reasonable way to repay their loans when starting out or when times are bad and a way to write-off the loans of those in cronic low income situations without ruining their credit. It seems to me that the government has no business loaning money out on the basis of potential earnings without either accepting a greater risk at the repayment end or providing a reasonable method of eliminating defaults completely. In this regard, the Petri proposal hits the bulls-eye, again.

Second, students are frustrated by the fact that someone is ripping them off. The frustration is from the responsible students who will repay their loans. Why should they be charged an origination and insurance fee of 7%? They don't agree that they should be charged for the defaulted loans of someone else. The IDEA Loan would eliminate or substantially reduce these charges and allow the student to borrow the full amount of the loan at a reasonable interest rate. Students, under the direct loan concept are accountable for their own repayment and their own credit rating. They are no longer a vehicle to provide profits for lenders or guarantee agencies.

Third, students are frustrated with the complex and confusing repayment process. I believe that the repayment concept in the IDEA proposal would save considerable dollars for the student and the institution. Under H.R. 2336, the management of student loans is simplified and streamlined. For example, our institution spends approximately 6-7 hours per week working with lenders and guarantee agencies regarding alleged defaulted loans of currently enrolled students, many of which were the result of erroneous mailing addresses and lost deferment forms. Removing someone who was erroneously placed in default may take weeks. Under IDEA, there are no defaults. Students and parents will know where the loan came from (the federal government through the school), how much it was for (the face value of the amount borrowed), who they are to repay (the federal government), and where they repay the obligation (the IRS). They will know that they will be tracked through the IRS and, therefore, are more likely to repay their loans. Since the IRS is tracking the same individuals for income tax purposes, it would seem that a duplication of effort could be avoided at considerable cost savings to the government.

The Petri proposal caught my attention as a positive consumer oriented act. The proposal addresses some major student financial aid issues head on...from a problem-solving standpoint. The problems I hear from students and parents every day have been addressed in this proposed legislation. The ability to respond quickly and efficiently to the changing situations of students would be a major plus for financial aid offices. Control of the amount and delivery of loan checks is a major plus. Simplification, equal access to loans for all families and a unique repayment process, which resolves a national embarrassment, are additional advantages.

I do find support among the small institutions for the general concepts proposed in this Act. Most feel that they are able to provide the quality service neccessary to administer a direct loan program. Indeed, the only concern I have had expressed to me is a fear that lenders may cease lending to students before the direct loans become available.

Student loan defaults, a problem which is built into the current system, will only get worse. The default problem will only get resolved through a unique repayment system, similar to the one proposed in this Act.

As with any bill this large and complex, opposition will surface armed, I am sure, with all of the facts and figures to prove this or that can't be done. I hope, in the process of marking-up the Reauthorization of the Higher Education Act, that you will remember the smoking phone and some of us who are financially unable to testify in person and enact legislation which addresses some of the frustrations of the consumer.

TESTIMONY ON

H.R. 2336, THE "INCOME-DEPENDENT EDUCATION ASSISTANCE ACT OF 1991" AND H.R. 3050, THE "SELF-RELIANCE SCHOLARSHIP ACT OF 1991"

BEFORE THE SUBCOMMITTEE ON POSTSECONDARY EDUCATION, U.S. HOUSE OF REPRESENTATIVES

Barry Bluestone

Professor of Political Economy
and Senior Fellow, John W. McCormack
Institute of Public Affairs

University of Massachusetts at Boston

November 14, 1991

TESTIMONY OF BARRY BLUESTONE ON H.R. 2336, THE "INCOME-DEPENDENT EDUCATION ASSISTANCE ACT OF 1991" AND H.R. 3050, THE "SELF-RELIANCE SCHOLARSHIP ACT OF 1991" BEFORE THE SUBCOMMITTEE ON POSTSECONDARY EDUCATION, U.S. HOUSE OF REPRESENTATIVES

November 14, 1991

I would like to thank Congressman William D. Ford for the opportunity to testify before this Committee on two important pieces of legislation, H.R. 2336, the "Income-Dependent Education Assistance Act of 1991" and H.R. 3050, the "Self-Reliance Scholarship Act of 1991". These two bills, along with companion legislation recently proposed in the U.S. Senate by Senators Paul Simon and David Durenberger (S. 1845) and Senator Bill Bradley (S. 1562), as well as Senator Daniel Akaka's call for a higher education finance demonstration project (S.1414), represent in my opinion an idea whose time has come. Each of these bills in its own way would provide postsecondary students with a rational, equitable, and fiscally responsible method for financing their own educations.

This legislation exemplifies a fresh approach to one of the two domestic issues most on the minds of American voters as they look toward the 1992 elections. Unquestionably, the special Senate election held earlier this month in Pennsylvania highlights the strong political sentiment in this country for innovative federal initiatives which can deal with the mounting problem of providing universal medical care. I am quite certain that if a opinion survey were taken today, the financing of postsecondary education would place high up on a list of politically salient issues along with the desirability of some form of national health insurance.

I would like to use this opportunity not so much to examine the details of the two bills specifically under consideration during this hearing, but to testify to the need and propriety of the general approach to higher education finance found in H.R. 2336 and H.R. 3050. In doing this, I will draw on my own work in this area -- particularly in the background research for the "Equity Investment in America" program developed with the assistance of my colleagues, Alan Clayton-Matthews and John Havens of Boston College and Howard Young of the University of Michigan.[1]

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[1] See Barry Bluestone, Alan Clayton-Matthews, John Havens, and Howard Young, "Financing Opportunity for Post-Secondary Education in the U.S.: The EQUITY INVESTMENT IN AMERICA Program," Briefing Paper, Economic Policy Institute, June 1990 and Barry Bluestone, Alan Clayton-Matthews, John Havens, and Howard Young, "Generational Alliance: Social Security as a Bank for Education and Training," The American Prospect, Summer 1990, pp. 15-29.

Elements of a Good Postsecondary Education Financing System

H.R. 2336 and H.R. 3050 differ in detail, but share in common three critical elements:

(1) Universal Eligibility
(2) Direct Federal Funding
(3) Income-Contingent Repayment

For brevity, we can refer to any higher education loan system containing these elements as a "**U-D-I-C Loan Program**".

The superiority of a UDIC loan program over current funding mechanisms for postsecondary education is based on a combination of all three elements:

Universal Eligibility - Under current financial arrangements, when it comes to paying for the costs of attending college, the wealthy and a small but select number of low-income students have things pretty well in hand. Wealthier students, by virtue of their family's economic circumstances, generally pay these costs out of existing assets. High ability low-income students, on the other hand, have available to them an array of government and private sector grants and scholarships. In contrast, most low income and virtually all moderate income families have been left to fend for themselves. Just when postsecondary education is taking on greater value for the individual and for the competitive position of the nation, the current system of finance fails to provide a suitable method of finance for the vast "middle class."

The new proposed legislation deals with this issue directly. Under every one of the bills, virtually every student in an accredited institution of higher education is eligible for loan support regardless of family income. Middle class students as well as those from wealthy families can take advantage of the proposed new programs without placing any burden on the taxpayer since the full value of the loans plus interest are repaid. Current grant support is maintained for low income students in order to supplement available loans and provide an incentive for pursuing postsecondary education.

(continued)

Parts of this testimony are also drawn from a paper, "Income Contingent Student Loans," (October 25, 1991) of which I am a co-author along with Jerome M. Comcowich of the University of Hawaii.

Direct Funding - Current federal loan programs (e.g. the Stafford and Perkins loans) provide an interest subsidy to students and a loan guarantee to private banks. The upshot of this system is an implicit subsidy to the banking system and a high rate of defaults. Defaults on student loans now run more than $1.5 billion per year.

By providing loans directly to students, bypassing the banking system, and by collecting loan repayments through the Treasury Department with the cooperation of the Internal Revenue Service, direct funding reduces the administrative costs of the program and virtually eliminates non-payment.

Income Contingency Repayment - Current loan programs require students to repay education loans at a fixed rate once they leave school. For many students this means they are forced to make repayments before their incomes reflect their added earning capacity. For others, this means repaying loans even if they are unemployed. This not only puts enormous economic pressure on students, but contributes to the high default rates found in current student loan programs.

Under the proposed legislation, loan repayments are income contingent. They vary with the income of the recipient and as such reduce the strain of repaying the loans, particularly under adverse economic conditions. As incomes rise, repayment increases. Repayment rates can be set along with the length of the repayment period so that the government is effectively assured of a full return of principle and interest.

The Discrepancy between School Cost and School Resources

The need for a new financing mechanism for postsecondary education is not difficult to document. At the very same time that schooling beyond high school is becoming more critical for individual as well as national economic growth, the cost of schooling is accelerating faster than the rate of inflation. Public resources available for loans and grants are by no means keeping pace with need. This is true for low income families, but even more apropos for the middle class. According to Kenneth C. Green of the Center for Scholarly Technology at the University of Southern California, the "sticker shock" of tuition and fees is forcing students to "buy down." Students who would have gone to private institutions are selecting public ones. Those who would have gone full time are forced to go part time. Some who would have selected four-year colleges are going instead to two-year schools, and more students from poor homes are going to vocational schools rather than college -- if they go anywhere at all. A recent USA Today survey of high school graduates suggests that some students are now falling out, not just "buying down." One-third of the students intimated they had delayed or indefinitely put off college because of the expense.

Anyone with college age children can attest to the burden of college costs. The College Board reports that by 1988-89 the cost to an in-state student for four years of school at a 4-year public college or university averaged over $23,000 including tuition and fees, room and board, and miscellaneous school expenses. The same education at a private 4-year institution was just under $50,000. At the elite schools, total expenses run closer to $90,000. Yet, the amount of student aid available from the federal government in the form of grants and loans has not kept up with these costs. In 1979, according to the The American Freshman survey conducted by the Higher Education Research Institute at UCLA, nearly 32 percent of all freshman students received Pell grants to attend college. Ten years later, the percentage was down to less than 22 percent. Meanwhile the proportion of students receiving Stafford and Perkins loans from the federal government has risen only marginally, from 21 to 25 percent between 1979 and 1989.

The only reason why college enrollments have not fallen off precipitously in light of the growing gap between costs and aid is that colleges and universities are themselves assuming a greater share of the expense burden, providing more grants and scholarships generated out of their own revenue. The UCLA survey notes that between 1979 and 1989, the percentage of freshman receiving college grants and scholarships increased from 11.3 to 20.3 percent. Part of the higher tuitions being charged by schools is being used to subsidize students from low and lower-middle income backgrounds simply to maintain cultural and social class diversity in the classroom.

Part of the difficulty is that the federal government has moved to disenfranchise middle class students from federal assistance by restricting eligibility for grants. In 1979, the government set a $32,500 ceiling on family income for a student to be eligible for grant support. Today, despite inflation, a family must have an income no higher than $28,000 to be eligible for aid. Even then, if a student is still eligible for a grant, the amount provided has not kept up with increases in college costs. The largest of the federal loan programs, the Stafford Student Loan, provides a maximum of $2,625 per academic year for the first two years of undergraduate study and $4,000 for each subsequent year, up to a five year maximum of $17,250. Hence, a student who takes out the maximum amount of Stafford loans over four years still must come up with another $9,750 on average to attend a public university and at least $26,750 to go private. Perkins Loans have higher maximums, but fewer than 3 percent of all freshman take advantage of them.

For those not eligible for federal grants or loans, going to the private market can cost a bundle. One example is the Education Resources Institute TERI loan. With a TERI loan, a student can borrow up to $20,000 a year with no income limit or "needs test". However, the standard rate on TERI loans is the prime rate plus 2 percent. With a deferment on interest and principal while in school, a typical loan of this variety with a 5-year term carries an annual percentage rate (APR) of 15.3% at regular commercial banks. Professional Education Plan (PEP) loans for graduate study can be even more expensive if thw student does not have a co-applicant. The APR on a 5-year loan with a 2-year deferral of principal and interest is currently in the range of 18%.

On top of high interest rates, the standard loan programs require students to begin paying back large sums as soon as they finish school despite the fact that their initial earnings are almost always modest. It is not surprising that the default rate on education loans is now 18 percent for those who went to 2-year public colleges, 14 percent for those who attended 2-year private schools, 7 percent for those who went to either private or public 4-year schools, and a whopping 33 percent for those who used their loans to go to trade schools.

The Practical Benefits of U-D-I-C based Loan Programs

Restructuring post-secondary education finance along the lines of the proposed **U-D-I-C** legislation deals directly with a number of problems inherent in current methods of supporting students in their quest for schooling.

(1) UDIC loans eliminate much of the morass of current federal loan programs in favor of one universal, comprehensive plan available to all postsecondary students.

(2) UDIC loans provide a substantially greater amount of funds under superior terms to most current programs, thus allowing students to better meet the rising cost of postsecondary education.

(3) UDIC loans are available to all students in accredited postsecondary schools regardless of family income. There is no "needs test". It is a middle class program every bit as much as one aimed at the low and moderate income student.

(4) Since repayment is based on actual earnings, there is effective deferral of principal and interest as long as the student is pursuing full-time studies and has little wage and salary income.

(5) UDIC loans can be made to apply equally to all forms of post-secondary schooling from apprenticeships and proprietary trade institutions to graduate and professional schools. They do not discriminate between the student who pursues, say, an undergraduate degree in political science and one who seeks retraining as a welder or office machine repairer.

(6) Racial and gender discrimination in the labor market is not automatically ratified as is the current practice under fixed obligation loans. The income contingent feature of UDIC loans requires students to repay based on actual earnings and therefore takes full account of differences in earnings for any reason.

(7) Because UDIC loans are income contingent, students will be more likely to enroll in programs that conform to their academic strengths and career goals than in programs which simply hold out the promise of extraordinarily high earnings that can be used to repay fixed short-term loans. This may mean slightly fewer students opting for law careers and MBAs and slightly more students preparing for careers in elementary and secondary school teaching, nursing, and other fields where the monetary rewards are smaller but the contribution to society is arguably no less and very likely greater.

(8) Under an UDIC loan program, students pay for their own education as the benefits from that education become manifest. In most cases, this will reduce the major financial burden on parents and shift much of it to their children who benefit directly from the educational investment.

(9) By setting repayment rates and the length of the repayment period appropriately, a UDIC program will be self-financing, thus reducing or eliminating any subsidy from the taxpayer.

(10) Finally, UDIC loans, by phasing out the Stafford and Perkins loan programs, frees up $5.1 billion of federal education spending per year. These dollars -- or at least a portion of them -- could be used to expand the Pell and SEOG grant programs for the most financially disadvantaged students.

There are likely to be other benefits as well: simplified and cheaper administration of education loans is surely one of them.

Some Tough Questions about U-D-I-C Loan Programs

Loan programs as ambitious and "newfangled" as those envisioned in H.R. 2336 and H.R. 3050 are bound to raise a number of questions about their funding, their impact on public and private institutions of higher education, and possible latent adverse side effects such as tuition cost inflation. A number of these can be answered here.

Q. Won't the implementation of a large scale U-D-I-C program add too much to what we spend on postsecondary education?

A. No, for two reasons. First, UDIC programs simply substitute a better financing mechanism for an inferior patchwork quilt of current funding programs. Second, at least a small increase in higher education is now warranted by the high rates of return that college and university graduates now obtain. We are no longer, "overeducated" as was the belief during the 1970s when returns to higher education temporarily waned. One quantitative measure of the value of education beyond the high school diploma is the enhanced earnings that educational investments produce for those who pursue college and university training. My colleagues and I have calculated that in 1990 dollars, the present discounted value of completing some college beyond the high school degree over the lifetime of the average worker is approximately $140,000. The present discounted value of four or more years of college is nearly $500,000. These higher earnings reflect higher productivity.

Q. Won't a UDIC loan program jeopardize public higher education by encouraging students to enroll in more expensive private schools?

A. Unlikely. While the repayment rates are reasonable, students will still be forced to pay a significant amount of their earnings over a substantial period of time in loan repayments. As a result, students will not automatically abandon public higher education for higher priced private schools. Likewise, the maximum lifetime limits stipulated on awards in most of the UDIC programs force students to be price conscious in making their investment decisions. Moreover, it is not unreasonable to expect that the overwhelming majority of individuals who decide to pursue higher education precisely because of UDIC loans will choose lower priced public colleges and universities, boosting the overall numbers going into the public sector.

Q. Won't a UDIC program lead to enormous increases in the level of tuition and fees?

A. Not necessarily. Continued competition between schools for a relatively stable number of college and university students will ultimately require high priced private schools to limit increases in their tuition and fee schedules. This is likely to occur with or without UDIC loans. In any case, if tuition does continue to skyrocket at private schools, the correct remedy is one that is now being implemented, at least tentatively: antitrust action. Ultimately, the agency entrusted with implementing the UDIC program could be a powerful ally against college cost inflation by refusing to permit students to use federal loan funds at schools that persist in raising tuition and fees to unacceptable levels.

Public colleges and universities may be another case. They may use the UDIC program to reduce the size of state government subsidies. Given the interstate mobility of students after graduation and the subsidy of middle class students on funds raised by regressive state taxes, increases in in-state tuition may, in fact, be justified. In an era of restrictive state budgets, UDIC loans would relieve states of some of the tuition burden. Yet, in order to maintain a "good business climate", one can expect state legislatures to maintain relatively low college and university tuition and fee rates in order to provide strong incentives for their citizens to pursue what is presumably productivity enhancing higher education.

Q. What keeps unscrupulous operators from setting up "sham" training schools to take advantage of UDIC-funded students?

A. All UDIC programs require that institutions eligible for federal loans be fully accredited and licensed by the states within which they operate. Moreover, the UDIC loan authority could be given oversight authority to do spot checks on state accreditation and licensing. To keep tuition and fees in line, the cost of education could be made one criterion for UDIC loan accreditation.

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Q. Won't the substitution of a UDIC program for current federal loan programs force colleges and universities to spend a much greater effort on administering financial aid?

A. No. The creation within the federal government of a special agency or "Trust" to administer the UDIC program will take much of this burden off of the individual school. Of course, schools will have to continue to supply the federal government with basic information about enrollment status and provide a campus-based office where students can receive their loan payments.

Q. How will a UDIC program likely affect low-income students?

A. Most UDIC plans provide additional resources to low-income students. First, the program permits students to borrow more funds with more reasonable repayment schedules. Second, Congress can take a portion of the $5.1 billion saved by eliminating the Stafford and Perkins loan programs and transfer it into the Pell and SEOG grants which have been especially helpful to low-income students.

Q. Will implementation of a federal UDIC program make state college prepayment programs like that in Michigan obsolete?

A. No, not necessarily. States which wish to set up college prepayment programs can do so regardless of UDIC loans. Parents who wish to make substantial contributions to their children's education can do so using this mechanism.

Q. Won't a UDIC program have a negative effect on philanthropic contributions to institutions of higher education?

A. Probably not. Most corporate and individual giving to higher education is for capital expansion, not current expenses. One suspects that corporations and individuals will continue to contribute to college and university endowments for such purposes.

Answering these questions obviously will not mollify all those who would oppose such a program. Moving toward such a radical restructuring of education finance will certainly have its detractors. Private banks, subsidized by government guaranteed student loans, will certainly balk at losing this lucrative market. Those who are part of the vast bureaucracy involved in servicing the current array of loans may also object on self-interest grounds to a system that makes their efforts largely unnecessary. However, the gains from implementing a UDIC loan plan -- from the perspective of students, their families, and the corporate sector advocating more resources for education -- presumably should carry the day.

Indeed, it is the rare government program that simultaneously satisfies a number of disparate public policy goals and at the same time has the opportunity to garner broad bipartisan support. The UDIC-type legislation now under consideration by this Committee has the potential for being one of these. By providing a significant increase in the level of federal funding available for post secondary education, by appealing to the needs of the middle class student as well as the student from the low-income family, and by providing a prudent investment opportunity for the U.S. Treasury, a UDIC higher education loan program meets both the criteria of efficiency and equity for a government program.

The specifics of the program can be debated and revised, but the basic structure provides a sound basis for promoting the national debate on how America can renew its commitment to education and to equal opportunity. Put simply, expanding on the principles set forth in H.R. 2336 and H.R. 3050 could be the ideal way to pay for education in the future.

STATEMENT

SUBMITTED FOR THE RECORD

FEBRUARY 6, 1992 HEARING

OF THE

SUBCOMMITTEE ON POSTSECONDARY EDUCATION COMMITTEE ON EDUCATION AND LABOR

by

American Association of Community and Junior Colleges
American Association of State Colleges and Universities
American Council on Education
Association of American Universities
National Association of College and University Business Officers
National Association of Independent Colleges and Universities
National Association of State Universities and Land-Grant Colleges

Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to provide the Subcommittee with the views of this group of higher education associations on the appropriate role of income-contingent repayment of federal loans, and on HR 2336 and HR 3050, which authorize new unsubsidized loan programs providing income-contingent repayment.

The Current Role of Student Loans

About half of the college enrollment, over 5 million students, currently receive some form of federal need-based aid. Grant resources are restricted by federal and state budget constraints, and although most students work, jobs do not provide sufficient income to be a primary financing mechanism for most full-time students, particularly for those who do not live at home while attending college, and those attending higher-priced institutions. Thus, loans are a necessary part of the financial aid package for many undergraduate and graduate students. Over 4 million students currently receive federal loans.

The primary goal of the grant, work and loan programs authorized under Title IV of the Higher Education Act is to equalize educational opportunity and to enable citizens to attend postsecondary education even if the financial resources of their families are inadequate. These programs are based on a partnership between students, families, and federal and state governments to enable needy students to finance postsecondary education.

The federal statute expects families of needy students to contribute a reasonable amount toward the student's educational expenses, including student self-help. Federal and state grant, work, and loan programs try to cover the remaining cost of attendance.

We believe that these expectations continue to be appropriate -- that parental resources and federal and state grants should continue to provide the major support in the student aid package for the needy traditional college-age undergraduate population, and that federal and state grants should continue to supplement savings and earnings for needy older students who are financially independent of their parents. For both groups of needy students, loans should be a supplemental source of assistance, not the major source of financing, and loan repayment should not work an undue hardship on needy borrowers, many of whom are at-risk students.

Role of Current Programs

There are three ways in which public policy can insure that repayment of federal loans is not onerous: one is to limit the amount that students can borrow, particularly in the early years of a student's college program; another is to make the terms and conditions of loan repayment as simple and flexible as possible; and a third is to subsidize a portion of the federal cost of the loan.

The federally-guaranteed bank-based Stafford loan program attempts to meet these goals through a number of mechanisms: lower loan limits in the first two years, in-school interest subsidy, federal subsidy of the difference between student interest rates and market rates, subsidy of defaults by the federal government and student insurance premiums, and provisions for deferments, consolidation, and forbearance during repayment.

Because of the desire to minimize student debt, Congress has authorized the PLUS program of loans for the parents of dependent students, which do not subsidize in-school interest, and carry a higher interest rate than Stafford loans, but which provide access to credit over a 10-year period that these families might not have otherwise. We strongly support the continuation and strengthening of the PLUS program to help parents finance their children's education. We have recommended that loan limits on this program be removed so that credit-worthy parents can borrow up to the cost of their children's education minus other student aid.

We also recognize the need for the Supplemental Loans for Students (SLS) program for independent students who do not qualify on the basis of need for Stafford loans, or who, as graduate or professional students, need to augment the amount of their Stafford loans. The statute also attempts to make these loans manageable for eligible students, but it provides a minimum of federal subsidy. Since the interest rate is higher than the Stafford rate and is not paid by the federal government while the student is in school, we hope that most undergraduate students, particularly at-risk students, do not have to assume this kind of debt, particularly in the early years of their undergraduate program. When interest is not paid by the federal government while the student is in school and is capitalized, interest accrues on interest. If the student remains in school for a number of years, the debt service during repayment can easily become burdensome. This is presumably why Congress has been reluctant to open up the SLS program, without restriction, to dependent undergraduate students.

Policy Issues

There is increasing pressure from students and families to provide higher loan limits in the subsidized Stafford program to help them finance postsecondary education. Current budget restrictions make this difficult to do because they require that a method of financing be provided for any federal additional subsidy in entitlement programs. Further, there is apprehension among many in the community and Congress that students will not be able to manage the increasing debt, even when in-school interest is federally subsidized, during the statutory 10-year repayment period.

The other major federal policy problem is default on Stafford and SLS loans. The federal government currently pays over $3 billion annually in default claims to lenders; it anticipates that about half of this amount will ultimately be repaid. The Department of Education has documented that borrowers with low-incomes prior to enrollment and after enrollment have the most difficulty repaying loans on the statutory repayment schedules, and have the highest default rates. When borrowers default, the federal government pays off the lender; then the state guaranty agencies and the federal government collect as much principal and interest as they can from the borrower -- in effect running an income-contingent loan program, but one which leaves the borrower with the stigma of default, a bad credit history, and loss of eligibility for Title IV funds.

The recent interest in income-contingent repayment in a direct federal lending program is prompted by these related goals -- namely, providing a way for students to borrow and repay larger loans while minimizing the federal subsidy and alleviating the default problem, which has tarnished the reputation of federally-guaranteed student loans.

Association Recommendations

Our response is threefold. Number one, we believe that it is far better policy for parents to assume greater responsibility for their dependent children's education than for the students to do it. Thus, we recommend increasing the ability of parents to borrow under the PLUS program.

Second, inasmuch as increased student borrowing may be inevitable, particularly among older independent students, we believe that the federal government has the responsibility to provide loans at the lowest possible cost to needy, at-risk students with repayment terms that are in the students' best interest and enable them to repay without default.

Third, we believe that undergraduate and graduate students from families who may not meet the federal criteria for "need" and borrow under an unsubsidized federal program should have access to repayment terms that enable them to meet their federal obligations for repayment with a minimum of hardship and adverse impact on career choice.

Under the credit reform provisions of the Budget Enforcement Act, it appears that greater benefits for borrowers are possible at lower cost to the federal government by using direct federal borrowing rather than capital supplied by commercial banks. We proposed in our package of reauthorization recommendations submitted to the Subcommittee in April that institutions should have the option to participate in such a direct lending program with subsidies similar to those provided in the Stafford program.

HR 3553 includes a direct federal lending proposal similar to the one we proposed, requiring the Secretary of Education to offer income contingent, graduated repayment, and conventional repayment options to student borrowers. The CBO has estimated that direct federal lending could achieve sufficient savings to finance the increased benefits, including increased limits for loans subsidizing in-school interest, offered under this proposal. Further, an income contingent repayment option, as well as regular amortization and graduated repayment, are easier because fewer steps are required than under a bank-based program.

The need for flexible repayment terms, however, goes far beyond the group of students who participate in a new direct loan program. Students are currently borrowing over $10 billion annually under the Stafford and SLS programs, and over $50 billion is outstanding. We propose, therefore, that a comprehensive set of repayment options for all federal loans be offered to all student borrowers irrespective of the specific federal loan program under which they have borrowed, under policy guidelines which protect the students' interests and are not so costly to the federal government that they cannot be enacted in the current budget climate.

Congress has provided hardship deferments, graduated repayment (at lender option), forbearance, and loan consolidation for borrowers. The first three are helpful to borrowers with short-term difficulties; and loan consolidation is appropriate for those with large debts and good incomes who need a longer period in which to repay.

There is a further group of borrowers who need additional help, and that is those whose income in repayment is inadequate to service their debt for a period of years, that is, those whose debt service exceeds 10% of their income. This group includes those who dropped out of school and whose financial circumstances did not significantly improve as a result of their postsecondary experience, as well as those who choose a career in a public service field with an annual salary less than their total debt. We believe that these borrowers should have the option to petition the government to allow them to repay on an income-contingent basis for as long as the period lasts in which their income is inadequate to service their debt without undue hardship. During this period, interest which is not covered by their repayments should be forgiven and should not be added to their total debt. We believe that this period will be temporary for most borrowers, but if for some it is not, we believe that at the end of 20-25 years, the remainder of the loan should be forgiven.

We realize that banks are unwilling to take on broad scale income-contingent repayment without an enormous increase in the special allowance. An even more significant issue is that we do not believe income-contingency and extended repayment are necessarily appropriate for all borrowers. Since interest accrues on the principal of all federal student loans throughout the repayment period, it is to the borrower's advantage to pay the interest as it accrues and to repay in as short a time as is reasonable to avoid excessive debt service. For those borrowers whose incomes in repayment are inadequate to service their debt without undue hardship or default, we recommend that the GSLP be modified to allow the federal government to buy up loans from eligible borrowers who petition for income-contingent repayment as it does for those in default. The federal government, working through state agencies, could purchase all the borrower's guaranteed loans, combine them with any other direct federal loans, and allow the borrower to repay on an income-contingent basis during the period in which the borrower's income was insufficient to repay without undue hardship.

The basic principle which we believe is necessary in any income-contingent program is that the federal government, not higher income borrowers, subsidize the interest payments of borrowers whose incomes after leaving school are too low to cover the cost of interest as it accrues in repayment, and that unpaid interest for this group of borrowers not be added to the borrowers' principal.

Problems with HR 2336 and 3050

We believe that HR 2336, the "Income-Dependent Education Assistance Act" (IDEA), introduced by Congressman Petri, and HR 3050, the"Self-Reliance Scholarship Act," introduced by Congressman Miller, contain elements that are worthy of consideration. Both bills authorize unsubsidized loan programs, but neither would replace the Stafford loan program. Both bills would use federal borrowing as the source of loan capital to provide loans with lower student interest rates. Both attempt to make repayment of student loans more manageable for students and the federal government, and would alleviate the default problem, with its attached stigma for at-risk students. The student would repay on an income-contingent basis, and IRS would be responsible for collections through payroll-tax withholding. The potential advantage of IRS collection of student loans has attracted the attention of many of our members for years. We have not seen analysis of this approach and look forward to the assessment by IRS on the feasibility and projected cost of this system.

Both bills, however, would establish large-scale programs that allow students to borrow amounts greatly in excess of current programs, require one group of student borrowers to subsidize another group of student borrowers in order to avoid any federal subsidy, and attempt to make these changes to federal student loan policy acceptable by providing income-contingent repayment and extending the repayment period to 25 years.

For the majority of students, extending repayment to 25 years, that is, into middle-age, is not an unqualified benefit, particularly in an unsubsidized program in which unpaid interest is steadily accruing. Income contingent repayment in and of itself does not minimize the amount of principal and interest which must be paid. We believe that the particular combination of features in the programs proposed by these bills would add excessively to student debt, and shift responsibility from parents and the government to students.

As Dr. Bruce Johnstone, now the Chancellor of the State University of New York system, wrote in 1972, "we do *not* feel that income contingency should be embraced as a major source of new revenue or as a painless way for parents, taxpayers, or hard-pressed governments to shift substantially more of the costs of higher education onto the student. Income contingency 'at its best' -- even with substantial low-income protection -- is not so much better than conventional debt that it can eliminate the added financial burdens upon the student of a shift in the balance of public versus private support.... Decisions on pricing policy and the allocation of financial responsibility among parents, students, and the government are vastly more important and fundamental than decisions with respect to a particular credit instrument. A preoccupation with income contingent loans or with any other means of coping with the costs of higher education can only obscure these fundamental questions."

Although the programs proposed in these two bills would supplement the existing federal loan programs rather than replace them (except for SLS), we believe that their long-run effect could be to undermine support for the principles embedded in the existing need-based subsidized federal programs: that unsubsidized student loans should not be the major financing mechanism, particularly for dependent students; that parents should bear the primary responsibility for this group, and that the federal government, not other borrowers, should bear the cost of a borrower's failure to repay, not other borrowers.

It is inherently difficult to assess how much it costs to subsidize borrowers with low after-school incomes in an income contingent program. The Congressional Budget Office (CBO) in its analysis of HR 2336 documents the difficulty in assessing the costs of the IDEA proposal, stating, "We can make only educated guesses about the future incomes of these students, but these assumptions are essential for determining costs." We believe that the cost of income contingency on an exception basis for hardship cases is more manageable, and, like defaults, is an appropriate federal cost.

HR 2336 explicitly attempts to avoid any federal subsidy of borrowers with low post-college incomes by having higher income borrowers pay at a higher interest rate than borrowers are currently charged under the SLS program. The basic rate for all borrowers would be the rate of 91-day T-bills plus 2%, not to exceed 10%, but if a borrower's post-college income were high enough to repay the loan in 12 years or less, an "early repayment" penalty would be charged. At the end of 25 years, or in case of death or disability, the loan would be forgiven. Borrowers whose incomes after leaving school are so low that they do not file income tax forms would not have to make payments.

According to the CBO, "The early repayment penalty would be equivalent to the additional amount that would have been owed if the loan had been originally charged an interest rate that was higher by 2.5 percentage points." That is, the borrower who repaid the loan early would be charged an effective interest rate of T-bill plus 4.5%. CBO's analysis projected that the range of subsidy to borrowers would vary widely, depending on income, but that middle- and high-future income borrowers would have a net negative average subsidy. That is, for every dollar the federal government lends to these borrowers, it would make a profit on a net present value basis. We believe that this is inappropriate for federal programs designed to assure postsecondary opportunities.

The federal subsidy in the SLS program at the present time is limited to default costs, as noted by CBO director Robert Reischauer in his October 11, 1991, letter to Congressman Petri. We believe that the inability of borrowers to repay loans after leaving school should continue to be borne by the federal government and not be shifted to higher income students.

Even though repayment would be limited to a percentage of income, borrowers with low incomes after graduation could still repay extremely large amounts of interest as well as principal, because of the high loan limits and absence of subsidy, and because repayment would continue for 25 years. Interest would accrue while the borrower is in school, and during repayment periods in which the percentage of the borrower's income required for repayment is not sufficient to cover interest, resulting in negative amortization.

We have no CBO analysis of HR 3050, but the bill states that its goal is to be self-financing. It allows students to borrow up to $10,000 per year, with a maximum of $33,000. Length of repayment options would range from 15 to 25 years, and there is a penalty for prepayment. There is also a surcharge for borrowers earning over $1 million annually after graduation. To cover program costs, there would be a minimum repayment for all borrowers, irrespective of how low their income after leaving college. Borrowers earning below 66% of the average salary of the college-educated population would have their payments calculated as if they did earn 66% of the average salary. This program would provide a significant increase in the total aggregate federal loans for which a student could apply, and the precise repayment terms, including the amounts of principal and interest paid, are critical to any assessment of its equity and desirability. We would need an exhaustive analysis of the impact of the program's repayment provisions on borrowers from varying post-college income levels before we could fairly comment, but it appears that the desire to make the program self-financing has produced terms and conditions that are unattractive to borrowers whose post-college incomes are either very high or very low.

In conclusion, we support income-contingent repayment for students who have difficulty repaying federal loans of all types, including borrowers who enter low-paying professions and have difficulty repaying on standard repayment schedules. Further analysis of the repayment formulas used in these bills would be useful in developing prototypes to be used in such cases. Many of our members would support an income contingent repayment plan that is part of a loan program that provides, overall, the maximum benefits to students.

We also support institutions having the option to use direct federal lending to provide greater student benefits at lower federal cost. We applaud the inclusion of direct lending in HR 3553, but we recommend that the loan limits under this bill be the same as those of current programs during the phase-in, that both large and small institutions be encouraged to participate, and that the phase-in period should allow the opportunity for Congress to assess progress and make any necessary adjustment. Our analysis indicates that there are fewer steps involved in providing flexible repayment terms under direct lending than under a bank-based program.

Further, we believe that federal loan programs, particularly those for undergraduate students, should contain some level of federal subsidy, such as at least the modest amount in the SLS program covering defaults, rather than having borrowers with high incomes after graduation subsidize those with lower incomes, or those with low incomes repay a percentage of income which they do not have.

COHEAO
COALITION
OF
HIGHER
EDUCATION
ASSISTANCE
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February 4, 1992

The Honorable William D. Ford
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Ford:

On behalf of the Coalition of Higher Education Assistance Organizations (COHEAO) we are writing to express strong objections to the direct lending proposal contained in H.R. 2336.

The membership of COHEAO includes campus-based student loan managers, loan servicing and collection entities and other organizations interested in the operational aspects of student lending. These are individuals with in-depth knowledge about how student loan programs operate on campus, who are often charged with designing and implementing default management programs and who have actively participated in the development of H.R. 3553, the House bill to reauthorize the Higher Education Act of 1965, as amended.

For the following reasons, COHEAO objects to your proposal to establish a direct lending program, mandating income-contingent repayment and utilizing the Internal Revenue Service to perform all collections functions:

*IDEA would substantially increase the repayment obligations for middle-income borrowers through the capitalization of interest during the in-school period and the extended repayment period

*IDEA denies students the in-school interest subsidy currently paid by the government on their behalf in the GSL program

*IDEA discourages families from saving for the education of their children by making large loan amounts available to borrowers

*IDEA would impose origination, record keeping and reporting responsibilities on many schools that do not want them and cannot afford them

The Honorable William D. Ford
February 4, 1992
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*IDEA discriminates against individuals on the basis of age by restricting access to loans beginning at age 35

*IDEA eliminates "defaults" caused by borrower inability to pay through loan forgiveness, creating the appearance of reform without addressing the problem of excessive borrowing

*IDEA will serve to undermine the rationale for any grant programs for students by making excessive loan funds available and allowing low-income earners to have their debts forgiven

*IDEA will impose on the Department of Education an administrative burden they admittedly cannot manage

*IDEA complicates the tax system by using IRS as a collection agency for student loans

*IDEA is extremely complicated and the repayment system is very difficult to explain to borrowers.

*IDEA removes from the student loan market place those entities charged with providing training, oversight and checks and balances which assure program integrity.

At the COHEAO Annual Meeting and Student Loan seminar held last week in Washington D.C., the attached analyses of the issues campuses must address to implement direct lending were presented to the membership. We thought they would be of interest to you and other members of the Committee on Education and Labor and ask that they be included in the record for the February 6, 1992 hearing on Direct Loans. Thank you for your time and interest in our concerns.

Sincerely,

Gary
Gary Hauser
President
COHEAO

Judy
Judith Flink
Vice President
COHEAO

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"An Examination of Campus Implementation of Direct Lending a Mixed View"
Presented During a Panel Discussion on Direct Lending
at the COHEAO Annual Meeting, January 28, 1992

Presented by:
Judith Nemerovski Flink
Vice President of COHEAO
Director of Student Financial Services and Cashiering Operations
at the University of Illinois at Chicago

"An Examination of Campus Implementation of Direct Lending: A Mixed View"

The University of Illinois at Chicago is a public university with approximately 24,500 students, 60 per cent of which receive some form of federal financial assistance. Our participation in the Guaranteed Student Loan Programs amounts to an annual loan volume of over $20 million with over 5,000 loans issued.

While the concept of direct lending merits consideration and further investigation I do not endorse the proposals for direct loan programs included in House Bill 3553 or Senate Bill 1845 introduced by Senators Simon and Durenberger. After conducting my own analysis of both proposals I concluded that either proposal for direct lending would increase my institution's workload without providing a substantial benefit for the student. Let me preface my remarks by noting that the proposed bills do not provide the detail needed to do an in-depth institutional administrative cost analysis. Many of the costs assumed by the institution will be the result of Department of Education regulations.

House Bill

Under the House direct lending proposal loan origination becomes the responsibility of the school. This process will increase administrative costs borne by institutions. Yes, schools are currently originating Perkins Loans, but the Perkins Loan Program at institutions are much smaller than the Guaranteed Loan Programs. My university has an annual Perkins volume slightly more than $3 million, whereas our Guaranteed Student

Loan volume exceeds $20 million. This would mean originating nearly seven times more loans.

The origination of the loans by the school does not guarantee that a student will receive their funds faster than under the current system. The school will have to estimate the amount of direct loan funds needed well in advance of the academic year. If the amount or the format of the request is incorrect delays would result. Schools will experience restrictions similar to the Pell Grant Program in estimating campus loan needs. This in addition to the complexity of federal budget restrictions and the timing of the schools governing board establishing tuition and fee amounts will increase the probability of adjustments and delays in funds.

Under the direct loan program students would now sign promissory notes at the institution and the institution would maintain a file of promissory notes in addition to sending the note to the Department of Education. For the institution this means having the facility and staff to accommodate a large number of students signing promissory notes and the physical space and staff to maintain these notes.

The school would be responsible for transmitting the loan notes to the Department of Education along with information on borrower status to perhaps more agents than under the current system. The school would than need to reconcile their information with the information the agency reported as received.

The added responsibility of loan origination and the volume of loans increases the probability of mistakes by the institution such as incomplete promissory notes or lost notes. Institutional liability under the proposal is uncertain but there is a likelihood that the institution would be financially liable for all errors. The additional responsibilities assumed with direct lending and the sheer volume of loans increases the probability of institutional errors. Under the current Guaranteed Program approximately 11 percent of all loan default claims are not paid by guaranty agencies or the Federal Government due to defects in originating and servicing. But instead are paid primarily by loan holders and servicing agents. (NASFAA, Oct. 1991)

As direct lenders schools could also be involved in borrower lawsuits alleging that they did not receive the education they were promised or that the school did not comply with applicable state or federal disclosure or other consumer protection laws. Borrowers could make claims that under these conditions they should not be responsible for repaying their loan obligations. (ISAC, Oct. 1991)

Under the House program the institution would receive a lump sum payment for loan recipients. The institution would have to reconcile the direct loan account. Institutions currently reconcile their Perkins accounts, but as I already indicated the direct loan account would be substantially larger.

For students who withdraw from the University in the middle of the term the institution will have to adjust the promissory note to reflect the change in status. The institution would have to maintain proper documentation and perform accepted accounting procedures for comprehensive audits of the program. The institution would be subject to audits similar to those performed on lenders. For the protection of the institution an expansion of internal audit and review procedures would be advisable.

Without lending institutions involved in the process institutions would be the sole provider of loan counseling. My institution has benefitted from the literature and counseling videos produced by lenders. The quality of loan counseling students would receive without lender participation may be in question. Without the lenders and the guarantors in the process the focus will be on institutions to reduce defaults.

To cover these administrative costs an administrative fee of $20 per loan is included in the proposal, subject to the annual appropriation cycle of Congress. Congress may decide to cancel the fee. In my and many of my colleagues opinion, this administrative fee will not offset the increased financial risks and administrative costs. We place the cost of origination at $50 to $100 per loan. In addition, the administrative fee for a public institution will go to the general fund and not my department's budget. Financial aid administrators have made claims that the program will decrease the tasks a school performs. This may be true for the financial aid office but not the business office. Responsibilities are shifted but resources and personnel may not.

The Department of Education will be faced with new responsibilities including the development of a data base to track the loans. ED, however, has failed in its attempt to implement a National Data base. The implementation of an extensive data base that would provide both institutions and the Department with information needed to effectively manage the loan program based on ED's history may not be likely. The program also assumes that institutions have the computer capability to transmit and receive information. This not always true.

An important issue and one of great concern to myself is the phasing out of the current Guaranteed Student Loan Program. It will take about 20 years to phase out these loans.

I question the ability of ED to phase out the GSL program while implementing a direct loan program. The institution, during this phase out period would be maintaining dual loan programs. Even when the direct loan program is operational the institution will continue to answer inquiries about guaranteed loans and process deferments.

IDEA Program

I have several reservations about the IDEA Credit Bill and the effect the program will have on higher education institutions and students. IDEA eliminates interest subsidies and will cost students more money to repay the loan then the current Guaranteed Student Loan Programs.

Under the IDEA Program a borrower will be in repayment for a maximum of 25 years. After this period the loan balance will be forgiven by the federal government. This method of repayment eliminates student loan defaults. However, there is no way to predict the amount of loans that will be forgiven. Forgiveness could cost the federal government significantly more than loan defaults. A Congressional Report released in 1988 stated that Contrary to popular perception, the typical defaulter is not a "deadbeat" who refuses to pay, but appears to be a dropout who is unable to pay. Defaulters tend to be first year students, from low income and minority backgrounds, with a small balance loan who did not complete much more than the first year, have borrowed only once, receive no or little assistance from parents in repaying, are likely to be unemployed when the loans come due, and never make a payment." {Those students most likely to default under the current program are most likely to have their loans forgiven under the IDEA program. A student who borrowed $10,000 and earned $9,750 upon graduation with an annual income growth of 5 per cent would have $14,650 of the loan balance forgiven after the 25 year repayment period ceased.}

Similar to the House Bill, the IDEA bill creates additional administrative work for institutions. This additional work includes loan origination which involves producing promissory notes, having the student sign the note, maintain a loan file, sending the note to the federal government, and reconciling the drawdown account. During this current economic period many institutions are faced with serious budget shortfalls that would be further strained by the passage of the IDEA Bill with no provision for an administrative cost allowance. Both the House Bill and the Perkins Loan program provide the institution with an administrative allowance.

The IDEA program ties the student's repayment to post-school income. This could discourage both students and parents from saving for higher education. Since everyone qualifies for the loan there is no way to predict if this will increase the number of loans.

The program also leads to an intergenerational shift of debt...with students assuming the full responsibility of paying for higher education.

The IRS serves as the loan servicer for the IDEA program. The IRS will most likely resist a change to their intent of this magnitude. The IRS is in the business of collecting taxes, not student loans. I also have reservations about the quality of service students will receive dealing with this large bureaucracy when questions or problems arise. When students have difficulty resolving problems or have questions about their loans they are likely to contact the school since the school originated the loan. In many instances the institution may have to act in behalf of the student to resolve problems.

To conclude, I do not believe in abandoning our 26 year history of success with the Guaranteed Student Loan Programs for an untested and unproven program. The program can be modified more successfully than replaced. Forgiving loans under the IDEA Program could prove much more costly than current loan defaults. Many of the arguments for direct lending...standardization, simplification, and restoring the balance of loans and grants...could be incorporated in the current Guaranteed Loan Programs.

"An Examination of Campus Implementation of Direct Lending a Mixed View"

Presented During a Panel Discussion on Direct Lending
at the COHEAO Annual Meeting, January 28, 1992

Presented by:
Jeanne Dotson
Student Loan Account Supervisor
Concordia College
Moorhead, Minnesota

Concordia College is a private church related Liberal Arts College located in the heart of the Red River Valley in Moorhead, Minnesota. Our full time enrollment is 2933. The Federal, State, and Institutional grants and loans in the academic year 1990-91 totaled over $17 million dollars. The Financial Aid office employs the director and two assistants. My office has one person and that one person is me. This morning I would like to share some of my concerns and those concerns related to me by others in the private sector as well as the state in our geographical region. On Tuesday, December 10, 1991, Senator David Durenberger asked officials from Moorhead State University, Concordia College and Moorhead Technical College for input on his proposal that would shift the fundamental financial responsibility from parents to students. He went into considerable detail on his "IDEA CREDIT" proposal and quite honestly painted a pretty picture. He asked us if this was "the right thing to do"? This briefing was very well attended by the college presidents, Deans of Admissions, Financial Aids, Arts and Humanities, Fiscal Officers, and the news media. The proposal was met with an "incredible lack of enthusiasm" (in Senator Durenbergers words) by all who attended. The concerns voiced were with regard to his comments that "Higher Education is becoming a lifelong pursuit". Will this lifelong pursuit end up being a lifelong debt? The concept of having one format and one lender has appeal to most. The concern about certain details make this almost unacceptable, however. I do not believe that it is fair to let parents off the hook so easily. I believe in saving for your childrens education. I wonder how many young people today would be aware of the consequences of taking on a debt of up to $70,000.00? How many parents would just let their children take on this debt rather than contribute to their education? Please keep in mind that these young people will marry each other and then they are looking at potentially $140,000 to repay over the next 25 years. I don't know about you but 25 years after I graduated from college I would expect that I would be saving for my grandchilds education ---- not still paying for mine..... Back in our day......or should I say "my day" so that I do not offend anyone by making the assumption that all of you are "my age".....college was an investment that paid off with better jobs with security, higher pay with benefits, and the general consensus of a time in our lives well worth the effort. Todays young people face much lower expectations. If they are to mortgage their future for up to 25 years for a 4 year bachelors degree at the institution of their choice their return is often unemployment6 part time jobs with no benefits, minimum wage and a general consensus of "a time in their lives NOT worth the effort". How then are we going to keep young people in education with that great of a burden?

The loan programs that are in place, though not perfect at least ask the student and parent to share in the cost of higher education. Perhaps a more attractive rate for the PLUS program would do more to encourage parental participation than merely being required to inform the parent of PLUS availability. Further, tax benefits to families that encourage savings and provide deductions for tuition paid could encourage parents to do more. Parents are possibly better suited for repayment after the student completes his/her course of study than the student who is just beginning a career and/or family obligations. The financing of a post-secondary education is a partnership between the family, the school, and the government. This partnership has worked rather well in the past but now we are seeing the effects of an erosion of that partnership. Specifically, at Concordia, federal support to our students has declined by 10% in constant dollars from 1981-82 until 1990-91. This 10% decline is in loan, work, and grant funding combined. On a national level the mix of grant to loan for those same years has eroded from a 52/45 ratio to a 48/49 ratio. Students are being forced into assuming an increasing debt burden for their educational expenses.

This concern that students will borrow more than is necessary has been directed to Senator Simon and Senator Durenberger. The response from Senator Simon is his latest letter to me indicated that even though the limits in the first two years are comparable to what an independent student could borrow if she/he qualified for both a current Stafford and SLS, and the limit to the cost of attendance is maintained, that he intends to maintain the current provisions that provide financial aid officers with some discretion to control unnecessary borrowing. I would be interested in the data showing how many financial aid officers actually exercise this discretion when counseling a student who is trying to finance his/her education and all resources have been used because the parent having the knowledge of the loan limits has made the decision to allow the student to take on the extra debt rather than making the contribution themselves.

The use of the federal income tax system to collect student loans would significantly complicate the income tax process as well as creating burdens for companies of all sizes who have to adjust withholding to account for amounts owed on loans. The probability of tax disobedience is increased and in some instances I believe it could become a deterrent for a potential employer to hire a college graduate who has student loans. Furthermore, using the scenario of the average borrower who over the course of his/her education has borrowed a total of $40,000.00 through IDEA credit. The interest has accrued on this amount at 2% over the 91 day T-bill rate or the rate projected by the Congressional Budget Office of 8% and upon graduation the $40,000 has just become $45,918.00. After discussing this with our Financial Aid and Placement Director we felt it would be fair to say that a college graduate with a degree from a liberal arts college or university would make about $25,000 per year for his/her job. Senator Simon and Senator Durenberger have proposed that no payment may exceed 25% of the difference between actual income and the minimum filing income which is $5,550.00, (if single and under age 65) . This would mean, using that formula, that the monthly with holding could be as high as $405.20. With all the costs of starting up a "real life in the "real world" taken into considertation, can any of us realistically say upon the task of implementing a new program which will affect the future of the majority of our young people and the growth of our economy.

In closing please allow me to thank you for your kind attention. I realize that this is a very emotional topic and that each person and institution has its own position. I appreciate being able to share mine with you and I would ask that you not questions my dollar figures because I'm not very good with numbers and I would hate to make a fool of myself. Whatever time I may have left I will defer to Judith Flink. Thank you.

"An Examination of Campus Implementation of Direct Lending a Mixed View"

Presented During a Panel Discussion on Direct Lending
at the COHEAO Annual Meeting, January 28, 1992

Presented by:
Joseph A. Russo
Director of Financial Aid
University of Notre Dame
Notre Dame, Indiana

DIRECT LOAN PROPOSAL
MIXED VIEW

JOSEPH A. RUSSO

COALITION OF HIGHER EDUCATION ASSISTANCE ORGANIZATION
ARLINGTON, VIRGINIA

JANUARY 28, 1992

THANK YOU FOR THE OPPORTUNITY TO PROVIDE MY COMMENTS ON THE CONCEPT OF THE DIRECT LOAN PROGRAM. CERTAINLY THERE ARE MANY MAJOR ISSUES WHICH NEEDED OUR SERIOUS ATTENTION AS WE REVIEW THE FEDERAL LEGISLATION GOVERNING OUR STUDENT AID PROGRAMS. IN FACT, PRIOR TO THE BIRTH OF THE DIRECT LOAN PROPOSAL, LEGISLATORS AND OTHERS INVOLVED IN DEVELOPING PUBLIC POLICY AGREED THAT WE DESPERATELY NEEDED TO AVOID THE "TINKERING" WHICH THE REAUTHORIZATION PROCESS SEEMS TO HAVE EXPERIENCED THE LAST COUPLE OF TIMES AROUND AND RATHER CONCENTRATE ON THE MORE FUNDAMENTAL QUESTIONS OF LOAN/GRANT IMBALANCE, SIMPLICITY OF DELIVERY, AND INTEGRITY. CONSENSUS ON THESE AS MAJOR CONCERNS WAS ALSO FOUND AT THE PRACTITIONER LEVEL, I.E., THE FINANCIAL AID ADMINISTRATORS WERE ALSO IN AGREEMENT THAT THE HEAVY DEBT BURDEN, THE NEED FOR SIMPLICITY, AND THE NEED FOR INTEGRITY WERE THE BIGGEST ISSUES.

IN SOME PEOPLE'S VIEW, THE DEBATE OVER THE DIRECT LOAN PROGRAM HAS BEEN A MAJOR DISTRACTION TO THESE ISSUES. WITHOUT QUESTION, IT HAS CONSUMED A LOT OF TIME AND EFFORT. IN FACT, FOR SEVERAL MONTHS NOW, IT HAS PICKED UP CONSIDERABLE MOMENTUM, HAVING RECEIVED PUBLIC SUPPORT FROM SUCH INSTITUTIONS AS HARVARD AND MICHIGAN AND MANY OTHERS. RECENTLY, HOWEVER, THIS MOMENTUM HAS SLOWED, AS MORE OF US HAVE BECOME MORE VOCAL IN EXPRESSING OUR QUESTIONS.

IN MY REMARKS TODAY, I WILL INDEED RAISE SOME OF MY CONCERNS. BUT PRIOR TO DOING THIS, I BELIEVE WE SHOULD ALL ASK VERY SERIOUSLY, IF THE DIRECT LOAN PROPOSAL WERE SUCH A LOUSY IDEA, WHY HAS IT RECEIVED SO MUCH INTEREST AND SUPPORT? WHY WAS IT NOT SIMPLY IGNORED?

I WOULD CONTEND THAT THE PRIMARY REASONS IT HAS NOT DIED A QUICK DEATH RELATE TO THE FRUSTRATION THAT MANY HAVE WITH THE PROBLEMS SO OFTEN ASSOCIATED WITH STUDENT AID

IN GENERAL: IT'S TOO COSTLY, TOO COMPLICATED, AND FRAUGHT WITH FRAUD AND ABUSE. DO THESE PROBLEMS SOUND FAMILIAR? IN FACT, THEY ARE RIGHT ON TARGET WITH THE VERY BASIC ISSUES OF EXCESSIVE BORROWING, THE NEED FOR SIMPLICITY, AND THE NEED FOR INTEGRITY--ALL OF WHICH WERE AGREED UPON BASIC PUBLIC POLICY THEMES IN NEED OF SERIOUS REVIEW PRIOR TO THE DISCUSSIONS SURROUNDING THE REAUTHORIZATION DEBATES IN CONGRESS.

WHY IS THE COST OF THE STAFFORD STUDENT LOAN PROGRAM GROWN SO DRAMATICALLY IN THE LAST DECADE? ARE THE COSTS REQUIRED TO DELIVER THESE FUNDS TO STUDENTS EXCESSIVE? HOW DOES THE FACT THAT A RECENT STUDY OF BANKS' LENDING ACTIVITIES SHOWING STUDENT LOANS TO BE THE THIRD MOST PROFITABLE VENTURE BEHIND CREDIT CARDS AND COMMERCIAL MORTGAGES RELATE TO THE QUESTION OF EXCESSIVE COST? CAN THESE PROFIT MARGINS BE REDUCED BY A FEW BASIS POINTS WITHOUT SIGNIFICANTLY IMPACTING THE ABILITY OF LENDERS TO PROVIDE TIMELY AND ACCURATE LOANS? CAN CURRENTLY AVAILABLE MODERN TECHNOLOGY BE EMPLOYED TO REDUCE COSTS AND COMPLEXITY IN THE DELIVERY OF STUDENT LOAN PROCEEDS? WHY CANNOT ALL OF THE AGENCIES INVOLVED IN DELIVERY AGREE TO SOME COMMON STANDARDS FOR REPORTING? WHY DO WE HEAR SO MANY COMPLAINTS FROM BORROWERS RESULTING FROM LOANS BEING SOLD AND SOMETIMES SOLD AGAIN AND MOVED FROM ONE PART OF THE COUNTRY TO ANOTHER FOR SERVICING? WHY DOES THE IMAGE OF STUDENT AID CONTINUE TO DECLINE BECAUSE OF APPARENT BUREAUCRACY, COMPLEXITY, AND INSENSITIVITY TO ALL SORTS OF SPECIAL CIRCUMSTANCES OF STUDENTS AND FAMILIES? WHY TOO HAS OUR IMAGE BEEN FURTHER DAMAGED BY STORIES OF FRAUD AND ABUSE, CONGRESSIONAL INVESTIGATIONS REVEALING SCAM AFTER SCAM, LOUSY GRADUATION AND PLACEMENT RATES, AND OUTRAGEOUS DEFAULT RATES?

IT'S NO WONDER THAT SOME SUGGESTION TO CHANGE THE NATURE OF BY FAR THE LARGEST OF THESE STUDENT AID PROGRAMS--STUDENT LOANS--HAS PICKED UP SUCH SUPPORT AND RECEIVED SO LITTLE NEGATIVE REACTION... AT LEAST INITIALLY! I WHOLEHEARTEDLY AGREE WITH MANY WHO ESPOUSE THE NEED FOR CHANGE. IN FACT, AS HAS BEEN RATHER APPARENT, THE CHALLENGES RAISED BY THE DIRECT LOAN PROGRAM ARE VERY SIMILAR TO THOSE RAISED PRIOR TO THE BEGINNING OF THE LEGISLATIVE PROCESS RELATED TO REAUTHORIZATION. THIS DEBATE HAS NOT BEEN A DISTRACTION BUT RATHER REFLECTS MANY OF THE VALID PUBLIC POLICY QUESTIONS WE

SHOULD BE RAISING! AS MUCH AS I AM CONCERNED ABOUT MANY ASPECTS OF THE DIRECT LOAN PROPOSAL, I AM PLEASED THAT THE CONSIDERABLE ATTENTION IT HAS RECEIVED AT LEAST HAS THE POTENTIAL TO DO MUCH TOWARD CORRECTING SOME VERY FUNDAMENTAL PROBLEMS ASSOCIATED WITH HOW WE CURRENTLY GO ABOUT OUR BUSINESS. THE VERY WORST RESULT OF THIS ENTIRE NATIONAL DEBATE WOULD BE THAT THE REASONS BEHIND THIS CONCEPT'S BIRTH AND SUPPORT WOULD BE IGNORED. IN A NUTSHELL, I AM VERY MUCH IN OPPOSITION TO DISMANTLING THE CURRENT GUARANTEED STUDENT LOAN PROGRAM AND THE ESTABLISHMENT OF A NEW DIRECT LOAN PROGRAM... BUT I AM VERY SYMPATHETIC TO THE SERIOUS PROBLEMS IT IS TRYING TO ADDRESS. WHERE I DISAGREE WITH BETSY AND OTHERS SUPPORTING THE DIRECT LOAN, IS THE MANNER IN WHICH WE GO ABOUT SOLVING THE PROBLEMS. I FEEL STRONGLY THE WE CAN FIX THE PROGRAM, WHICH HAS WORKED SO WELL FOR SO MANY YEARS FOR SO MANY MILLIONS OF INDIVIDUALS AND SO MANY BILLIONS OF DOLLARS, WITHOUT THROWING THE ENTIRE THING OUT AND STARTING ALL OVER.

NOW LET'S LOOK MORE SPECIFICALLY AT THE DIRECT LOAN PROPOSAL. FIRST OF ALL, ITS IMPLEMENTATION WOULD REMOVE A NUMBER OF NON FEDERAL PLAYERS FROM THE PROCESS, INCLUDING BANKS, GUARANTORS, SECONDARY MARKETS, AND PRIVATE BILLING AND COLLECTION ORGANIZATIONS... THE ASSUMPTION BEING THAT THE QUALITY OF SERVICE BEING PROVIDED WOULD BE BETTER THAN THAT NOW BEING DRIVEN BY A MORE COMPETITIVE BASED MARKET. THE TRACK RECORD OF THE FEDERAL GOVERNMENT IN ADMINISTERING STUDENT AID IN AN EFFICIENT, TIMELY, AND ACCURATE MANNER HOWEVER, LEAVES MUCH TO BE DESIRED. JUST CHECK WITH SENATOR NUNN'S SENATE COMMITTEE'S REPORT TO CONGRESS, WHICH REFLECTED A TOTAL LACK OF CONFIDENCE IN THE FEDERAL GOVERNMENT'S ABILITY TO PROPERLY OVER-SEE ITS PROGRAMS. READ LAST WEEK'S CHRONICLE OF HIGHER EDUCATION ABOUT HOW THE EDUCATION DEPARTMENT'S ABILITY TO ACCURATELY MEASURE AN INSTITUTION'S DEFAULT RATE HAS BEEN CHALLENGED BY CALIFORNIA COMMUNITY COLLEGES. MOREOVER, THE U.S. DEPARTMENT OF EDUCATION HAS ITSELF, ALONG WITH THE ADMINISTRATION, INDICATED ITS SERIOUS CONCERN ABOUT BEING ABLE TO ADMINISTER A DIRECT LOAN PROGRAM. SUCH A TRACK RECORD AND PUBLIC POSTURE DO VERY, VERY LITTLE IN ESTABLISHING A FIRM LEVEL OF CONFIDENCE IN A PROPOSAL WHICH WOULD BE SO DEPENDENT UPON FEDERAL LEADERSHIP. AGAIN, THIS DOES NOT SUGGEST THAT THE QUALITY OF SERVICE PROVIDED

UNDER THE CURRENT GUARANTEED LOAN PROGRAM IS PERFECTLY ACCEPTABLE. IMPROVEMENT IS MUCH NEEDED BUT, I CONTEND, IS VERY ACHIEVABLE WITHIN THE CURRENT STRUCTURE.

THE DIRECT LOAN PROPOSAL IS ALSO BASED UPON A NUMBER OF OTHER ASSUMPTIONS WHICH ARE OPEN TO SERIOUS QUESTION. FOR EXAMPLE, IT ASSUMES THAT EACH INSTITUTION CURRENTLY PARTICIPATING IN THE PROGRAM WOULD BE WILLING AND CAPABLE OF BECOMING A DIRECT LENDER. MOREOVER, IT ASSUMES A VIRTUALLY UN-LIMITED AMOUNT OF LOAN DOLLARS BEING PROVIDED TO EACH INSTITUTION, REGARDLESS OF WHATEVER BUDGET DEFICIENCIES OR NATIONAL DEBT PROBLEMS BEING FACED IN OUR COUNTRY'S ECONOMY. ELIGIBLE STUDENTS ARE CURRENTLY ABLE TO SECURE LOANS. WOULD THE SAME ASSURANCE BE PROVIDED UNDER THE NEW PROGRAM? THE PROGRAM ALSO SUGGESTS THAT NEW EFFICIENCIES, SUCH AS ELECTRONIC FUNDS TRANSFER OR EFT, WOULD RESULT FROM DIRECT LOANS. ALTHOUGH SOME INTERSTATE BANKING REGULATIONS MAY INDEED NEED REVISING, EFT IS ALREADY TECHNICALLY POSSIBLE UNDER THE PRESENT PROGRAM. LIKEWISE, THE STANDARDIZATION ADVANTAGES WHICH WOULD PRESUMABLY FLOW FROM ONE DIRECT LOAN PROGRAM ARE ALSO ACHIEVABLE NOW UNDER THE GUARANTEED LOAN... IF WE CAN JUST GET TOGETHER AND WORK THEM OUT. I MIGHT ADD THAT THIS HAS BEEN A PARTICULARLY FRUSTRATING ISSUE FOR AN INSTITUTION SUCH AS BETSY'S AND MINE, WHICH DRAW ANNUALLY FROM A NATION WIDE CONSTITUENCY. HAVING TO WORK WITH OVER FIFTY DIFFERENT STUDENT LOAN APPLICATION PROCESSES, EACH WITH DIFFERENT FORMS, DIFFERENT DATA ELEMENTS, AND DIFFERENT POLICIES AND PROCEDURES, CAUSED US NO SMALL PROBLEMS. BECAUSE OF SOME SPECIAL CONSIDERATIONS OUR INSTITUTION WAS ABLE TO ARRANGE WITH AN ANNUALLY EVALUATED LIST OF PREFERRED LENDERS WORKING WITH ONE NATIONAL GUARANTOR CAPABLE OF ELECTRONIC PROCESSING, WE NOW HAVE GONE A LONG WAY DOWN THE ROAD TOWARD STANDARDIZATION. THIS HAS RESULTED IN POSITIVE CONSEQUENCES OF REDUCED COMPLEXITY, IMPROVED QUALITY OF SERVICE FOR BOTH BORROWER AND INSTITUTION, AND GREATLY ENHANCED CASH FLOW TO THE INSTITUTION. OTHER NATIONAL INSTITUTIONS HAVE ALSO ACHIEVED SIMILAR SUCCESSES. WHAT IF ALL OF OUR PARTICIPATING COLLEGES AND UNIVERSITIES GOT TOGETHER AND DEMANDED SUCH CHANGE, ESPECIALLY WITH SOME ENCOURAGING INCENTIVES BY CONGRESS? I BELIEVE THIS CAN AND SHOULD

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HAPPEN IN THIS REAUTHORIZATION PROCESS. I FOR ONE WOULD BE EXTREMELY DISAPPOINTED IF THIS DEBATE DID NOT RESULT IN SUCH CHANGE.

BETSY AND OTHERS HAVE ALSO MADE A NUMBER OF OTHER ASSUMPTIONS IN THEIR RATIONALE. IN WHAT HAS NOW BECOME A MATTER OF PUBLIC RECORD, BETSY AND KAY JACKS OF COLORADO STATE UNIVERSITY HAVE RATHER SIMPLISTICALLY SUGGESTED THAT SIGNIFICANT REDUCTIONS WOULD RESULT IN THE TASKS CURRENTLY PERFORMED BY SCHOOLS IN ADMINISTERING THE GUARANTEED STUDENT LOAN. BY SUBTRACTING THE FUNCTIONS THEY INDICATE WOULD BE ELIMINATED AND ADDING THE ALLEGED FEW WHICH A DIRECT LOAN WOULD REQUIRE, THEY SUGGEST THE NET RESULT WOULD BE SIGNIFICANTLY LESSENED ADMINISTRATIVE BURDENS. I BELIEVE AT LEAST BETSY WOULD CONCEDE THAT THEIR INITIAL ANALYSIS MAY BE IN NEED OF SOME CLARIFICATION. SINCE MANY OF THE NEW RESPONSIBILITIES REQUIRED AT THE SCHOOL LEVEL WOULD UNDOUBTEDLY FALL UPON PEOPLE LIKE YOURSELVES, I WOULD RECOMMEND THAT YOU TAKE A LOOK AT THE RESPONSE PREPARED BY COURTNEY McANUFF AND MYSELF LAST FALL WHICH IS A HANDOUT FOR THIS SESSION. SINCE WE WOULD EFFECTIVELY BECOME BANKERS, EACH INSTITUTION WOULD BE SUBJECT TO LEARNING AND STAYING ON TOP OF A WHOLE NEW SET OF BANKING REGULATIONS. WE WOULD, FOR EXAMPLE, NEED TO DO CREDIT WORTHY CHECKS ON AT LEAST SOME BORROWERS. WE WOULD ALSO BE HAVING TO DEAL WITH THE BILLING AND COLLECTING PROBLEMS TYPICALLY ASSOCIATED WITH BORROWERS UNABLE TO BE SATISFIED BY SOME FEDERAL CONTRACTOR--WHO, BY THE WAY, WOULD HAVE WON THE JOB BY BEING THE LOWEST BIDDER ON A FEDERAL CONTRACT SUBJECT TO CHANGE EVERY THREE YEARS! YOU MIGHT WANT TO BOUNCE THAT SCENARIO AROUND WITH YOUR SCHOOL'S ALUMNI DIRECTORS.

THE FINAL ASSUMPTION, AND PERHAPS THE ONE MOST SUSPECT, WOULD HAVE MANY OF THE DIRECT LOAN'S SUCCESSES BASED UPON THE EXISTENCE OF AN ACCURATE AND EFFICIENT NATIONAL DATA BASE OF STUDENT AID INFORMATION. THE NATIONAL DATA BASE WOULD ELIMINATE THE NEED FOR SUCH THINGS AS FINANCIAL AID TRANSCRIPTS AND CHECKING ON PREVIOUS PROBLEMS OF A STUDENT'S LOAN DEFAULTS OR REFUNDS DUE SOME FEDERAL AID PROGRAM, ETC. OF COURSE, THE DIRECT LOAN PROPOSAL WOULD HAVE THE FEDERAL GOVERNMENT PUT THIS NATIONAL DATA BASE FULLY IN PLACE IN THE FIRST YEAR OF THE NEW PROGRAM. THE LAST REAUTHORIZATION IN 1986 PROVIDED THE AUTHORITY FOR JUST SUCH A DATA BASE FOR STUDENT LOANS. THOSE OF US IN THE

STUDENT AID WORLD ARE STILL AWAITING ITS ARRIVAL. THE FEDERAL PELL GRANT APPLICATION PROCESS HAS ALSO ATTEMPTED TO GATHER SIMILAR DATA FOR THAT PARTICULAR FEDERAL PROGRAM. IT WOULD BE VERY KIND TO INDICATE THAT IT CURRENTLY LACKS THE FULL CONFIDENCE OF THOSE WHO HAVE TO WORK WITH IT.

BEYOND QUESTIONING THE ASSUMPTIONS BEHIND THE DIRECT LOAN PROGRAM, ONE MIGHT ALSO WONDER ABOUT ADDITIONAL DEMANDS THE FEDERAL GOVERNMENT MIGHT REQUIRE OF INSTITUTIONS. WHAT WOULD BE AN ACCEPTABLE FINANCIAL RATING AND HOW OFTEN WOULD IT HAVE TO BE REVIEWED AND AT WHOSE EXPENSE? WHAT WOULD BE AN ACCEPTABLE AMOUNT OF ADDITIONAL HUMAN RESOURCES REQUIRED TO PROPERLY ADMINISTER THE PROGRAM? WOULD THERE BE ANY OPPORTUNITY TO CUSTOMIZE THE BILLING AND COLLECTION PROCESS TO THE PARTICULAR KINDS OF CIRCUMSTANCES WHICH THE PERKINS PROCESS NOW PERMITS? WHAT ABOUT ALL OF THE OTHER QUESTIONS BEING CURRENTLY RAISED BY THE ACADEMIC SIDE OF THE INSTITUTION AS THEY RELATE TO ACCREDITATION ISSUES?

AGAIN, I WOULD BE THE LAST TO ARGUE THAT EVERY INSTITUTION PRESENTLY PARTICIPATING IN THE GUARANTEED STUDENT LOAN PROGRAM IS PERFECTLY IMMACULATE AND NOT WITHOUT FAULT. HERE AGAIN THE UGLY PICTURE OF FRAUD, ABUSE, SCAM, HIGH ATTRITION, FINANCIAL INSOLVENCY, AND OUTRAGEOUS DEFAULT RATES LOOMS BEFORE US. WE MUST ADDRESS THE ISSUE OF INTEGRITY VERY SERIOUSLY AND CREATE TOUGH NEW STANDARDS TO WHICH ALL SCHOOLS, LENDERS, AND AGENCIES MUST SUBSCRIBE. IN DEVELOPING THESE STANDARDS, WE MUST ALSO TARGET OUR PUNITIVE REGULATIONS TO THOSE WHOSE TRACK RECORDS OBVIOUSLY ARE WANTING. UNFORTUNATELY, THESE RULES ARE TOO OFTEN WRITTEN IN SUCH A BROAD BRUSHED APPROACH THAT WE ALL MUST SUFFER EQUALLY WITH EXCESSIVE ADMINISTRATIVE BURDENS. IN FACT, IN ADDRESSING THE INTEGRITY ISSUE, CONGRESS SHOULD PROVIDE EXEMPTIONS FROM CERTAIN REGULATIONS TO THOSE PLAYERS WHOSE RECORDS ARE ABOVE REPROACH. I WOULD SUGGEST THAT THEY SHOULD EVEN BE REWARDED WITH SPECIAL POSITIVE INCENTIVES IN ADDITION TO BEING EXEMPTED FROM BURDENSOME REGULATIONS. THIS CAN BE ACHIEVED IN THE CURRENT PROGRAM AND ONCE AGAIN I FIND MYSELF REPEATING THE THOUGHT OF HOW SAD IT WOULD BE THAT WE FAIL TO REALLY TACKLE THIS ISSUE THIS TIME AROUND.

I NEED NOT SPEND A LOT OF TIME WITH THIS AUDIENCE ON THE ISSUE OF LIABILITY. OBVIOUSLY, EACH INSTITUTION WOULD BE REQUIRED TO EXERCISE CONSIDERABLY MORE TIME AND EFFORT WITH EACH AND EVERY STEP OF THE DIRECT LOAN PROCESS, FAR BEYOND THE MANY RESPONSIBILITIES WE ALREADY CARRY UNDER THE CURRENT PROCESS. FAILURE TO DO SO WOULD RESULT IN THE SCHOOL'S FULL LIABILITY FOR THE LOAN. ALTHOUGH SPECIAL CARE SHOULD CERTAINLY BE TAKEN IN CERTIFYING LOAN ELIGIBILITY FOR STUDENT BORROWERS, AN ENTIRELY NEW LEVEL OF INVOLVEMENT WOULD BE REQUIRED IF WE WERE TO BECOME BANKERS. A MORE SHARED RESPONSIBILITY IN ADMINISTERING STUDENT LOANS IS A VERY GOOD PUBLIC POLICY OBJECTIVE WHICH I WOULD WHOLEHEARTEDLY SUPPORT. HOWEVER, THE SCHOOL'S ROLE IN THIS REGARD SHOULD RELATE MORE TO THE INTEGRITY QUESTIONS OF A STUDENT'S OF ABILITY TO BENEFIT, GRADUATION AND PLACEMENT RATES, AND OTHER SIMILAR ISSUES RAISED EARLIER IN MY REMARKS.

FINALLY, WE MIGHT ALSO WANT TO REVIEW THE REASONS FOR THE DEMISE OF THE FEDERALLY INSURED STUDENT LOAN PROGRAM, ALSO KNOWN AS THE FISL PROGRAM. MANY OF THE QUESTIONS AND PROBLEMS SOME OF US HAVE WITH DIRECT LOANS WOULD FIND MANY PARALLELS WITH THOSE WHICH WERE ASSOCIATED WITH THE DEMISE OF THIS FEDERALLY CENTRALIZED PROGRAM. MOREOVER, IN PROJECTING THE DISMANTLING COSTS OF THE GUARANTEED LOAN PROGRAM, WE MIGHT WANT TO CHECK THE RECORD OF THE FISL--WHICH HAS BEEN OFF THE BOOKS FOR YEARS BUT IS STILL A COST TO THE GOVERNMENT DUE TO THE LONG TERM OBLIGATION TYPICALLY ASSOCIATED WITH STUDENT LOANS. KEEP IN MIND THAT THERE WERE FAR FEWER FISL BORROWERS AND INFINITELY LESS DOLLARS INVOLVED.

I APOLOGIZE FOR THE LENGTH OF MY REMARKS AND VERY MUCH APPRECIATE YOUR KIND PATIENCE AND ATTENTION. IN SUMMARY, I AM VERY SYMPATHETIC TO ADDRESSING THE SAME PROBLEMS WHICH A DIRECT LOAN PROGRAM WOULD ATTEMPT TO RESOLVE, BUT I STRONGLY BELIEVE THAT ALL OF THESE MAJOR PROBLEMS CAN AND SHOULD BE ADDRESSED IN THIS REAUTHORIZATION WITHIN THE CURRENT BASIC PARTNERSHIP OF PLAYERS IN THE GUARANTEED STUDENT LOAN PROGRAM. AFTER OUR OTHER PANELISTS HAVE CONCLUDED, I WOULD VERY MUCH BE INTERESTED IN YOUR COMMENTS AND QUESTIONS. THANK YOU.

II

102D CONGRESS
1ST SESSION

S. 1845

To ensure that all Americans have the opportunity for a higher education.

IN THE SENATE OF THE UNITED STATES

OCTOBER 22 (legislative day, SEPTEMBER 19), 1991

Mr. SIMON (for himself and Mr. DURENBERGER) introduced the following bill; which was read twice and referred to the Committee on Labor and Human Resources

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A BILL

To ensure that all Americans have the opportunity for a higher education.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Financial Aid for All Students Act of 1991".

TITLE I—PELL GRANT ENTITLEMENT, GRADUATE ASSISTANCE, AND EXCELLENCE SCHOLARSHIPS

SEC. 101. PELL GRANT ENTITLEMENT.

Section 411 of the Higher Education Act of 1965 (hereafter in this Act referred to as the "Act") (20 U.S.C. 1070(a)) is amended by adding at the end the following new subsections:

"(j) ENTITLEMENT TO AN ADDITIONAL $600.—(1) Notwithstanding the provisions of subsection (g), after July 1, 1994, no student shall be denied the additional amount to which such student would be entitled if the maximum basic grant allowable pursuant to the appropriate appropriation Act were increased by $600.

"(k) FULL ENTITLEMENT FOR ALL ELIGIBLE STUDENTS.—Notwithstanding the provisions of subsection (g), no student shall be denied the basic grant to which such student is entitled, as calculated under subsection (b), if Congress makes available for such purpose sufficient additional revenue or savings pursuant to the Budget Enforcement Act of 1990.".

SEC. 102. PELL GRANT FOR FIRST-YEAR GRADUATE STUDENTS.

Subsection (c) of section 411 of the Act is amended by adding at the end the following new paragraph:

"(4) A graduate student who has not completed the full-time equivalent of 1 year of coursework following the completion of the graduate student's first undergraduate baccalaureate degree shall be eligible for a basic grant in any fiscal year if—

"(A) sufficient funds have been made available to provide the basic grant for which all eligible undergraduate students are eligible in accordance with subsection (b) to all eligible undergraduate students; and

"(B) such graduate student would be eligible for a Pell grant if such student were an undergraduate student.".

SEC. 103. EXCELLENCE SCHOLARSHIPS FOR PELL GRANT RECIPIENTS.

Part A of title IV of the Act (20 U.S.C. 1070 et seq.) is amended by adding at the end the following new subpart:

"Subpart 9—Excellence Scholarship Program

"SEC. 420C. (a) PURPOSE.—It is the purpose of this part to award scholarships to Pell Grant recipients who demonstrate high academic achievement, and thereby encourage students to excel in elementary and secondary studies, enter postsecondary education, and continue to demonstrate high levels of academic achievement at the postsecondary level.

"(b) ENTITLEMENT PROGRAM.—The Secretary shall, in accordance with the provisions of this section, award scholarships to eligible students in accordance with this section. An eligible student shall be deemed to have a contractual right against the United States to receive a scholarship under this section.

"(c) ELIGIBLE STUDENT.—For the purposes of this section, the term 'eligible student' means a student that—

"(1) is enrolled on at least half-time basis in a program of study of not less than 2 academic years in length that leads to a degree or certificate;

"(2) has received a Pell Grant under subpart 1 of this part for that academic year; and

"(3) in the case of a student who will be attending such student's first year of postsecondary education—

"(A) has demonstrated academic achievement and preparation for postsecondary education by taking college preparatory level coursework equivalent to not less than 4 years of English, 3 years of science, 3 years of mathematics, 3 years of social science (including history), and 2 years of a foreign language, unless the Secretary determines that such courses were not available to the student; and

"(B) ranks in the top 10 percent, by grade point average, of the student's secondary school graduating class;

"(C) achieves at least the minimum score, as determined by the Secretary pursuant to regulations that are published in the Federal Register, on 1 of the nationally administered, standardized tests identified by the Secretary; or

"(D) has participated, for a minimum period of 36 months, in a program authorized under section 415F or under subpart 4 of this part or a similar program as determined by the Secretary;

"(2) in the case of a student who initially qualified for a scholarship as a first year student pursuant to subparagraph (c)(3)(D) of this section, participates in a student support services program described in subpart 4 or a similar program as determined by the Secretary in which such student is required to enter into an agreement to achieve certain academic milestones and the student continues to make significant progress toward those milestones; and

"(3) in the case of any other student—

"(A) ranks in the top 10 percent, by cumulative grade point average (or its equivalent, if the institution does not use a system of ranking its students by grade point averages), of the student's postsecondary education class as of the last academic year of study completed; or

"(B) meets another measure of academic achievement as determined by the Secretary.

"(d) SCHOLARSHIP AMOUNT.—

"(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the amount of a scholarship awarded under this section for any academic year shall be $1,000.

"(2) RELATIONSHIP WITH OTHER ASSISTANCE.—Notwithstanding the provisions of paragraph (1), the amount of a scholarship awarded under this subpart shall be reduced, by the institution of higher education that the student is or will be attending, by the amount that the scholarship—

"(A) exceeds the student's cost of attendance, as defined in section 472; or

"(B) when combined with other Federal or non-Federal grant or scholarship assistance the student receives in any academic year, exceeds the student's cost of attendance, as defined in section 472.

"(3) REDUCTION.—Notwithstanding the provisions of paragraph (1), if the Secretary projects that the total amount of scholarships to be awarded during an academic year under paragraph (1) will exceed $500,000,000, then the Secretary shall reduce the amount of each scholarship awarded under this section on a pro rata basis such that the projected total amount will not exceed $500,000,000.

"(e) PERIOD OF SCHOLARSHIP.—

"(1) IN GENERAL.—An eligible student may receive not more than 4 scholarships under this section, each awarded for a period of 1 academic year, except that, in the case of a student who is enrolled in an undergraduate course of study that requires attendance for the full-time equivalent of 5 academic years, the student may receive not more than 5 scholarships under this section.

"(2) SPECIAL RULE.—A student's eligibility for a scholarship under this section for an academic year is not dependent on whether the student received an excellence scholarship, Pell Grant, or any other aid in the previous academic year.

"(f) ADMINISTRATIVE PROVISIONS.—

"(1) IN GENERAL.—The Secretary shall promulgate regulations establishing the procedures by which scholarships under this section shall be awarded.

"(2) INFORMATION.—Each institution of higher education receiving a payment under this section shall provide to the Secretary such information as is required by the Secretary regarding a potential scholarship recipient's rank or test score.

"(3) INSTITUTIONAL PAYMENTS.—The Secretary shall make payments of scholarship proceeds on behalf of eligible students to the institutions of higher education at which such students are enrolled.".

TITLE II—INCOME-DEPENDENT EDUCATION ASSISTANCE PROGRAM

SEC. 201. IDEA CREDIT.

(a) IN GENERAL.—Part D of title IV of the Act is amended to read as follows:

"PART D—INCOME-DEPENDENT EDUCATION ASSISTANCE CREDIT

"SEC. 451. ENTITLEMENT PROGRAM.

"(a) IN GENERAL.—The Secretary shall, in accordance with the provisions of this part—

"(1) make loans to eligible students; and

"(2) enter into an agreement with the Secretary of the Treasury for the collection of repayments on such loans in accordance with section 459.

"(b) ENTITLEMENT PROVISION.—An eligible student shall be deemed to have a contractual right against the United States to receive a loan under this part.

"(c) DEFINITIONS.—For purposes of this part—

"(1) the term 'eligible institution' has the meaning given to such term by section 435(a); and

"(2) the term 'eligible student' means a student who is eligible for assistance under this title in accordance with section 484 and is carrying at least one-half the normal full-time work load for the course of study the student is pursuing as determined by the eligible institution.

"(d) REFERENCES.—A loan pursuant to this part may be referred to as an 'IDEA' loan.

"SEC. 452. ELIGIBILITY; USE OF LOANS.

"(a) ELIGIBILITY.—An eligible student shall not be eligible for a loan under this part unless—

"(1) in the case of an independent student with an adjusted gross income in the applicable year of less than $40,000 (or an appropriate amount determined by the Secretary), the eligible student has applied for need-based assistance under this title;

"(2) in the case of a dependent student with a family income in the applicable year of less than $60,000 (or an appropriate amount determined by the Secretary), the eligible student has applied for need-based assistance under this title;

"(3) in the case of a dependent student with an expected family contribution (excluding the student's own contribution) exceeding $2,000 (or an appropriate amount determined by the Secretary), the head of household has been notified of such person's eligibility for a loan under section 428B; and

"(4) such eligible student understands and signs directly beneath the following statement: 'I understand that taking this loan will increase the income taxes I owe each year until the loan is paid in full, with interest.'.

"(b) USE OF LOAN.—Each eligible student receiving an IDEA loan shall use the proceeds of such loan only to attend an eligible institution.

"SEC. 453. DISTRIBUTION TO ELIGIBLE INSTITUTIONS AND STUDENTS.

"The Secretary shall prescribe by regulation a process for the distribution of funds authorized by this part to eligible institutions and eligible students. To the extent that the distribution process would be simpler and would improve program accountability, the process shall be similar to the procedure under paragraphs (1) and (2) of section 411(a).

"SEC. 454. AMOUNT AND TERMS OF LOANS.

"(a) ELIGIBLE AMOUNTS.—

"(1) ANNUAL LIMITS.—Any individual who is determined by an eligible institution to be an eligible student for any academic year shall be eligible to receive an IDEA loan for such academic year in an amount which is not less than $500 or when combined with other Federal student assistance received by the student is not more than the cost of attendance at such institution for the academic year 1991–1992, determined in accordance with section 472. Notwithstanding the preceding sentence, the amount of such loan shall not exceed—

"(A) $6,500 in the case of any eligible student who has not completed the second year of undergraduate study;

"(B) $8,000 in the case of any eligible student who has completed such second year but who has not completed such student's course of undergraduate study;

"(C) $20,000 in the case of any eligible student who is enrolled in a medical or other high-cost doctoral degree program as determined by the Secretary;

"(D) $30,000 in the case of any eligible student who is enrolled in an extraordinarily high-cost graduate degree program as determined by the Secretary; or

"(E) $11,000 in the case of an eligible student who is enrolled in any other graduate degree program.

"(2) LIMITATION ON BORROWING CAPACITY.—No individual may receive any amount in an additional IDEA loan if the sum of the original principal amounts of all IDEA loans to such individual (including the pending additional loan) would equal or exceed—

"(A) $70,000, minus

"(B) the product of—

"(i) the number of years by which the borrower's age (as of the close of the preceding calendar year) exceeds 40; and

"(ii) one-twentieth of the amount specified in subparagraph (A), as adjusted pursuant to paragraph (3).

"(3) EXCEPTIONS TO BORROWING CAPACITY LIMITS FOR CERTAIN GRADUATE STUDENTS.—For a student who is—

"(A) a student described in paragraph (1)(C), paragraph (2) shall be applied by substituting "$100,000" for "$70,000"; or

"(B) a student described in paragraph (1)(D), paragraph (2) shall be applied by substituting "$120,000" for "$70,000".

"(4) COMPUTATION OF OUTSTANDING LOAN OBLIGATIONS.—For the purposes of this subsection, any loan obligations of an individual under student loan programs under this title or title VII of the Public Health Service Act shall be counted toward IDEA loan annual and aggregate borrowing capacity limits. For purposes of annual and aggregate loan limits under any such student loan program, IDEA loans shall be counted as loans under such student loan program.

"(5) ADJUSTMENTS OF ANNUAL LIMITS FOR LESS THAN FULL-TIME STUDENTS.—For any eligible student who is enrolled on a less than full-time basis, loan amounts for which such student shall be eligible for any academic year under this subsection shall be reduced in accordance with regulations prescribed by the Secretary.

"(b) DURATION OF ELIGIBILITY.—An eligible student shall not be eligible to receive an IDEA loan for more than a total of the full-time equivalent of 9 academic years, of which not more than the full-time equivalent of 5 academic years shall be as an undergraduate student and not more than the full-time equivalent of 5 academic years shall be as a graduate student.

"(c) TERMS OF LOANS.—Each eligible student applying for a loan under this title shall sign a written agreement which—

"(1) is made without security and without endorsement, except that if the borrower is a minor and such note or other written agreement executed by such student would not, under the applicable law, create a binding obligation, endorsement may be required;

"(2) provides that such student will repay the principal amount of the loan and any interest or additional charges thereon in accordance with section 459;

"(3) provides that the interest on the loan will accrue in accordance with section 456;

"(4) certifies that the student has received and read a notice of the student's obligations and responsibilities under the loan, including the statement described in section 452(a)(4); and

"(5) contains such additional terms and conditions as the Secretary may prescribe by regulation.

"SEC. 455. APPLICATION.

"Each eligible student desiring an IDEA loan shall submit an application to the eligible institution which such student plans to attend. Each such application shall contain sufficient information to enable such institution to determine such student's eligibility to receive an IDEA loan.

"SEC. 456. INTEREST CHARGES.

"Interest charges on IDEA loans made shall be added to the recipient's obligation account at the end of each calendar year. Such interest charges shall be based upon an interest rate equal to the lesser of—

"(1) the sum of the average bond equivalent rates of 91-day Treasury bills auctioned during that calendar year, plus 2 percentage points, rounded to the next higher one-eighth of 1 percent; or

"(2) 10 percent.

"SEC. 457. CONVERSION AND CONSOLIDATION OF OTHER LOANS.

"(a) IN GENERAL.—The Secretary may, upon request of a borrower who has received a federally insured or guaranteed loan under this title or under title VII of the Public Health Service Act, make a loan to such borrower in an amount equal to the sum of the unpaid principal on loans made under this title or title VII of the Public Health Service Act. The proceeds of the new loan shall be used to discharge the liability on loans made under this title or title VII of the Public Health Service Act. Except as provided in subsection (b), any loan made under this subsection shall be made on the same terms and conditions as any other loan under this part and shall be considered a new IDEA loan for purposes of this part.

"(b) CONVERSION REGULATIONS.—The Secretary shall prescribe regulations concerning the methods and calculations required for conversion to IDEA loans under subsection (a). Such regulations shall provide appropriate adjustments in the determination of the principal and interest owed on the IDEA loan in order to—

"(1) secure payments to the Federal Government commensurate with the amounts the Federal

Government would have received had the original loans been IDEA loans;

"(2) fairly credit the borrower for principal and interest payments made on such original loans and for origination fees deducted from such original loans; and

"(3) prevent borrowers from evading their obligations or otherwise taking unfair advantage of the conversion option provided under this section.

"(c) MANDATORY CONVERSION OF DEFAULTED LOANS.—Any loan which is—

"(1) made, insured, or guaranteed under part B of this title or title VII of the Public Health Service Act after the date of enactment of this Act; and

"(2) assigned to the Secretary or the Secretary of Health and Human Services for collection after a default by the borrower in repayment of such loan,

shall, in accordance with regulations prescribed by the Secretary and the Secretary of Health and Human Services, be treated for purposes of collection as if such loan had been converted to an IDEA loan under subsections (a) and (b) of this section.

"SEC. 458. STUDY; REPORT; AND UPDATING.

"(a) STUDY.—The Secretary shall conduct a study of the effects of—

"(1) the loan program assisted under this part on—

"(A) the tuition rates of eligible institutions participating in such program; and

"(B) the accrediting and licensure standards of such institutions; and

"(2) inflation on—

"(A) the loan limits described in section 454;

"(B) the progressivity factor described in section 459(b)(3); and

"(C) the cost of attendance at an eligible institution.

"(b) REPORT.—

"(1) IN GENERAL.—The Secretary shall prepare and submit a report to Congress, including recommendations, on the results of the study conducted pursuant to subsection (a).

"(2) DATE.—The report described in paragraph (1) shall be submitted on or before December 31, 1995.

"(c) UPDATING.—For any academic year after academic year 1996–1997, the Secretary is authorized after consultation with the appropriate Congressional committees, to make adjustments to increase—

"(1) the loan limits described in section 454;

"(2) the adjusted gross income levels used to determine the progressivity factor described in section 459(b)(3`; and

"(3) the cost of attendance determination described in section 454(a)(1).

"SEC. 459. COLLECTION OF INCOME-DEPENDENT EDUCATION ASSISTANCE LOANS.

"(a) NOTICE TO BORROWER.—

"(1) IN GENERAL.—During January of each calendar year, the Secretary shall furnish to each borrower of an IDEA loan notice as to—

"(A) whether the records of the Secretary indicate that such borrower is in repayment status;

"(B) the maximum account balance of such borrower;

"(C) the account balance of such borrower as of the close of the preceding calendar year; and

"(D) the procedure for computing the amount of repayment owing for the taxable year beginning in the preceding calendar year.

"(2) FORM, ETC.—The notice described in paragraph (1) shall be in such form as the Secretary may by regulation prescribe and shall be sent by mail to the individual's last known address or shall be left at the dwelling or usual place of business of such individual.

"(b) COMPUTATION OF ANNUAL REPAYMENT AMOUNT.—

"(1) IN GENERAL.—(A) The annual amount payable under this section by the taxpayer for any taxable year shall be the lesser of—

"(i) the product of—

"(I) the base amortization amount, and

"(II) the progressivity factor for the taxpayer for such taxable year, or

"(ii) 20 percent of the excess of—

"(I) the modified adjusted gross income of the taxpayer for such taxable year, over

"(II) the sum of the standard deduction and any exemption amount applicable to such taxpayer's income tax return for the taxable year.

"(B) For purposes of subparagraph (A)(ii)(II)—

"(i) the term 'standard deduction' has the meaning given such term by section 63(c) of the Internal Revenue Code of 1986; and

"(ii) the term 'exemption amount' has the meaning given such term by section 151(d) of such Code.

"(2) BASE AMORTIZATION AMOUNT.—

"(A) IN GENERAL.—For purposes of this section, the term 'base amortization amount' means the amount which, if paid at the close of each year for a period of 12 consecutive years, would fully repay (with interest) at the close of such period the maximum account balance of the borrower. For purposes of the preceding sentence, an 8-percent annual rate of interest shall be assumed.

"(B) JOINT RETURNS.—In the case of a joint return where each spouse has an account balance and is in repayment status, the amount determined under subparagraph (A) shall be the sum of the base amortization amounts of each spouse.

"(3) PROGRESSIVITY FACTOR.—

"(A) IN GENERAL.—For purposes of this section, the term 'progressivity factor' means the number determined under tables prescribed by the Secretary which is based on the following tables for the circumstances specified:

"(i) JOINT RETURNS; SURVIVING SPOUSES.—In the case of a taxpayer to whom section 1(a) of the Internal Revenue Code of 1986 applies—

"If the taxpayer's modified adjusted gross income is:	The progressivity factor is:
Not over $7,860	0.429
11,700	0.500
16,740	0.571
21,720	0.643
26,880	0.786
32,700	0.893
39,060	1.000
48,600	1.000
63,480	1.152
87,360	1.272
117,000	1.364
163,080	1.485
240,000 and over	2.000

"(ii) HEADS OF HOUSEHOLDS.—In the case of a taxpayer to whom section 1(b) of the Internal Revenue Code of 1986 applies—

"If the taxpayer's modified adjusted gross income is:	The progressivity factor is:
Not over $6,540	0.429
10,320	0.500
12,300	0.607
16,080	0.643
19,920	0.714
25,020	0.857
31,380	1.000
37,740	1.000
47,280	1.094
63,180	1.313
85,440	1.406
114,060	1.500
204,000 and over	2.000

"(iii) UNMARRIED INDIVIDUALS, ETC.—In the case of a taxpayer to whom section 1(c) of the Internal Revenue Code of 1986 applies—

"If the taxpayer's modified adjusted gross income is:	The progressivity factor is:
Not over $6,540	0.467
9,000	0.500
11,580	0.533
14,220	0.600
16,740	0.667
19,920	0.767
25,020	0.867
31,380	1.000
37,740	1.000
45,360	1.118
58,080	1.235
82,260	1.412
94,320	1.500
168,000 and over	2.000

"(iv) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—In the case of a taxpayer to whom section 1(d) of the Internal Revenue Code of 1986 applies—

"If the taxpayer's modified adjusted gross income is:	The progressivity factor is:
Not over $3,930	0.483
5,850	0.552
8,370	0.655
10,860	0.759
13,440	0.862
16,350	1.000
19,530	1.000
24,300	1.182
31,740	1.333
43,680	1.485
84,000 and over	2.000

"(B) RATABLE CHANGES.—The tables prescribed by the Secretary under subparagraph (A) shall provide for ratable increases (rounded to the nearest 1/1,000) in the progressivity factors between the amounts of modified adjusted gross income contained in the tables.

"(4) MODIFIED ADJUSTED GROSS INCOME.—For purposes of this subsection, the term 'modified adjusted gross income' means adjusted gross income for the taxable year, modified as the Secretary determines is necessary to carry out the purposes of this part.

"(c) TERMINATION OF BORROWER'S REPAYMENT OBLIGATION.—

"(1) IN GENERAL.—The repayment obligation of a borrower of an IDEA loan shall terminate only if there is repaid with respect to such loan an amount equal to the principal amount of the loan plus interest computed at the rates applicable to the loan.

"(2) NO REPAYMENT REQUIRED AFTER 25 YEARS IN REPAYMENT STATUS.—No amount shall be required to be repaid under this section with respect to any loan for any taxable year after the 25th year for which the borrower is in repayment status with respect to such loan.

"(3) DETERMINATION OF YEARS IN REPAYMENT STATUS.—For purposes of paragraphs (1)(A) and (2), the number of years in which a borrower is in repayment status with respect to any IDEA loan shall be determined without regard to any year before the most recent year in which the borrower received an IDEA loan.

"(d) DEFINITIONS.—For purposes of this section—

"(1) MAXIMUM ACCOUNT BALANCE.—The term 'maximum account balance' means the highest amount (as of the close of any calendar year) of unpaid principal and unpaid accrued interest on all IDEA loan obligations of a borrower.

"(2) CURRENT ACCOUNT BALANCE.—The term 'current account balance' means the amount (as of the close of a calendar year) of unpaid principal and unpaid accrued interest on all IDEA loans of a borrower.

"(3) REPAYMENT STATUS.—A borrower is in repayment status for any taxable year unless—

"(A) such borrower was, during at least 7 months of such year, an eligible student; or

"(B) such taxable year was the first year in which the borrower was such an eligible student and the borrower was such an eligible student during the last 3 months of such taxable year.

"(e) LOANS OF DECEASED AND PERMANENTLY DISABLED BORROWERS; DISCHARGE BY SECRETARY.—

"(1) DISCHARGE IN THE EVENT OF DEATH.—If a borrower of an IDEA loan dies or becomes permanently and totally disabled (as determined in accordance with regulations of the Secretary), then the Secretary shall discharge the borrower's liability on the loan.

"(2) LIMITATION ON DISCHARGE.—The discharge of the liability of an individual under this subsection shall not discharge the liability of any spouse with respect to any IDEA loan made to such spouse.

"(f) CREDITING OF COLLECTIONS; SPECIAL RULES.—

"(1) CREDITING OF AMOUNTS PAID ON A JOINT RETURN.—Amounts collected under this section on a joint return from a husband and wife both of whom are in repayment status shall be credited to the accounts of such spouses in the following order:

"(A) First to repayment of interest added to each account at the end of the preceding calendar year in proportion to the interest so added to the respective accounts of the spouses.

"(B) Then to repayment of unpaid principal, and unpaid interest accrued before such preceding calendar year, in proportion to the respective maximum account balances of the spouses.

"(2) COMPUTATION OF ALTERNATIVE ANNUAL PAYMENT FOR INDIVIDUALS WHO HAVE ATTAINED AGE 55.—In the case of an individual who attains age 55 before the close of the calendar year ending in the taxable year, or of an individual filing a joint return whose spouse attains age 55 before the close of such calendar year, the progressivity factor applicable to the base amortization amount of such individual for such taxable year shall not be less than 1.0.

"(3) RULES RELATING TO BANKRUPTCY.—

"(A) IN GENERAL.—An IDEA loan shall not be dischargeable in a case under title 11 of the United States Code.

"(B) CERTAIN AMOUNTS MAY BE POSTPONED.—If any individual receives a discharge in a case under title 11 of the United States Code, the Secretary may postpone any amount of the portion of the liability of such individual on any IDEA loan which is attributable to amounts required to be paid on such loan for periods preceding the date of such discharge.

"(4) PAYMENTS IN EXCESS OF AMOUNT PAYABLE.—Nothing in this part shall be interpreted to prohibit a borrower from paying an amount in excess of the amount required to be repaid under this part.".

(b) APPLICATION OF ESTIMATED TAX.—Subsection (f) of section 6654 of the Internal Revenue Code of 1986 (relating to failure by individual to pay estimated income tax) is amended by—

(1) striking "minus" at the end of paragraph (2) and inserting "plus";

(2) redesignating paragraph (3) as paragraph (4); and

(3) inserting after paragraph (2) the following new paragraph:

"(3) the amount required to be repaid under section 6306 (relating to collection of income-dependent education assistance loans), minus".

(c) FILING REQUIREMENT.—Subsection (a) of section 6012 of the Internal Revenue Code of 1986 (relating to persons required to make returns of income) is amended by inserting after paragraph (9) the following new paragraph:

"(10) Every individual required to make a payment for the taxable year under section 6306 (relating to collection of income-dependent education assistance loans).".

(d) CLERICAL AMENDMENT.—The table of sections for subchapter A of chapter 64 of such Code is amended by adding at the end thereof the following new item:

"Sec. 6306. Collection of income-dependent education assistance loans.".

SEC. 202. REPAYMENTS USING INCOME TAX COLLECTION SYSTEM.

(a) Subchapter A of chapter 64 of the Internal Revenue Code of 1986 (relating to collection) is amended by adding at the end the following new section:

"SEC. 6306. COLLECTION OF INCOME-DEPENDENT EDUCATION ASSISTANCE LOANS.

"The Secretary of the Treasury shall enter into an agreement with the Secretary of Education to provide for the collection of payments due pursuant to part D of title IV of the Higher Education Act of 1965. The Secretary shall assess and collect such payments in the same manner, with the same powers, and subject to the same limitations applicable to a tax imposed by subtitle C the collection of which would be jeopardized by delay.".

TITLE III—EARLY INTERVENTION PROGRAM

SEC. 301. STATE DREAM FUNDS.

Subpart 3 of part A of title IV of the Higher Education Act of 1965 (20 U.S.C. 1070c et seq.) is amended by adding at the end thereof the following new section:

"SEC. 415F. EARLY INTERVENTION PROGRAM.

"(a) FINDINGS AND PURPOSE.—

"(1) FINDINGS.—The Congress finds that at-risk students who do not receive some form of intervention early in their educational careers (in most cases by junior high school) are more likely to drop out of school and not pursue gainful educational or employment opportunities as adults.

"(2) STATEMENT OF PURPOSE.—It is the purpose of this section to make incentive grants to States to enable States to conduct early intervention programs that—

"(A) raise the awareness of eligible students about the advantages of obtaining a postsecondary education; and

"(B) prepare students for postsecondary education; and

"(C) qualify students for scholarship assistance pursuant to subpart 9.

"(b) EARLY INTERVENTION PROGRAM ESTABLISHED.—

"(1) PROGRAM ESTABLISHED.—The Secretary shall make payments to States in accordance with paragraph (2).

"(2) AMOUNT OF PAYMENTS.—Except as provided in paragraph 3, for any fiscal year, the Secretary shall pay to each State an amount which bears the same ratio to $100,000,000 as the number of eligible students in such State bears to the total number of eligible students in all the States.

"(3) ENTITLEMENT.—Except as provided in paragraph 5, each State shall be entitled to receive the payment described in paragraph (2) in each fiscal year. Each State shall be deemed to have a contractual right against the United States to receive a payment in accordance with the provisions of this part.

"(4) REALLOTMENT.—If in any fiscal year the Secretary determines that any amount of a State's payment under paragraph (2) or (3) will not be required for such fiscal year for early intervention programs of that State or will be available as a result of the State's failure to comply with subsection (c), then such amount shall be available to make payments from time to time, on such dates during such year as the Secretary may fix, to other States in proportion to the original payment to such States under such paragraphs for such year, but with such proportionate amount for any of such States being reduced to the extent it exceeds the sum the Secretary estimates such State needs and will be able to use such year for carrying out the State plan. The total of such reductions shall be similarly paid among the States whose proportionate amounts were not so reduced. Any amount paid to a State under this paragraph shall be deemed part of its payment under paragraph (3).

"(5) PAYMENT SUBJECT TO CONTINUING COMPLIANCE.—The Secretary shall make payments for early intervention programs only to States which continue to meet the requirements of subsection (c).

"(6) DEFINITIONS.—For the purpose of this section—

"(A) the term 'eligible institution' has the same meaning provided such term in section 435(a); and

"(B) the term 'eligible student' means a student eligible—

"(i) to be counted under section 1005(c) of the Elementary and Secondary Education Act of 1965;

"(ii) for assistance pursuant to the National School Lunch Act; or

"(iii) for assistance pursuant to part A of title IV of the Social Security Act (Aid to Families with Dependent Children).

"(c) USE OF PAYMENTS.—

"(1) IN GENERAL.—A State shall use payments received under this section to conduct an early intervention program that—

"(A) provides eligible students in any of the grades pre-school through 12 with a continuing system of mentoring and advising that—

"(i) is coordinated with the Federal and State community service initiatives;

"(ii) may include such support services as after school and summer tutoring, assistance in obtaining summer jobs, and academic counseling; and

"(iii) may be provided by service providers such as community-based organizations, schools, eligible institutions, and public and private agencies, particularly institutions and agencies sponsoring programs authorized under subpart 4;

"(B) requires each student to enter into an agreement with the State under which the student agrees to achieve certain academic milestones, such as completing a prescribed set of courses and maintaining satisfactory academic progress as described in section 484(c), in exchange for receiving a scholarship pursuant to subpart 9;

"(C) contains an incentive system to encourage greater collaboration between elementary and secondary schools and institutions of higher education through the creation of new linkage structures and programs; and

"(D) contains an evaluation component that allows service providers to track eligible student progress during the period such students are participating in the program assisted under this section.

"(2) EVALUATION STANDARDS.—The Secretary shall prescribe standards for the evaluation described in paragraph (1)(E). Such standards shall—

"(A) provide for input from States and service providers; and

"(B) ensure that data protocols and procedures are consistent and uniform.

"(d) STATE PLAN.—

"(1) IN GENERAL.—Each State desiring a payment under this section shall submit a State plan to the Secretary at such time, in such manner, and accompanied by such information as the Secretary may reasonably require.

"(2) CONTENTS.—Each State plan submitted pursuant to paragraph (1) shall—

"(A) describe the activities for which assistance under this section is sought;

"(B) contain assurances that the State will provide matching funds to help pay the cost of activities assisted under this part in an amount equal to the Federal payment received under this part; and

"(C) provide such additional assurances as the Secretary determines necessary to ensure compliance with the requirements of this section.

"(3) APPROVAL.—The Secretary shall approve a State plan submitted pursuant to paragraph (1) within 6 months of receipt of the plan unless the plan fails to comply with the provisions of this section.

"(e) EVALUATION AND REPORT.—

"(1) EVALUATION.—Each State receiving a payment under this section shall annually evaluate the early intervention program assisted under this section in accordance with the standards described in subsection (c)(3) and shall submit to the Secretary a copy of such evaluation.

"(2) REPORT.—The Secretary shall annually report to the Congress on the activities assisted under this section and the evaluations conducted pursuant to paragraph (1).".

SEC. 302. CONFORMING AMENDMENT.

Section 415A(a) of the Higher Education Act of 1965 (20 U.S.C. 1070c(a)) is amended by adding the following new sentence at the end thereof: "It is also the purpose of this part to make payments to States to enable States to conduct early intervention programs described in section 415F.".

TITLE IV—GUARANTEED STUDENT LOAN PROGRAMS

SEC. 401. TERMINATION OF ALL LOAN PROGRAMS EXCEPT THE PLUS LOAN PROGRAM.

(a) STAFFORD LOANS, SUPPLEMENTAL LOANS AND PLUS LOANS.—Notwithstanding any other provision of law, no new loans shall be made, insured or guaranteed pursuant to part B of title IV of the Higher Education Act of 1965 after June 30, 1994, except loans made, insured or guaranteed pursuant to section 428B of such Act.

(b) ADMINISTRATION.—The provisions of this section shall not affect the administration of the loans described in subsections (a) and (b) made on or before June 30, 1994.

○

102D CONGRESS
1ST SESSION

H. R. 3050

To amend the Higher Education Act of 1965 to establish a higher education loan program in which the amount of a student's loan repayment is contingent upon such student's income, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

JULY 25, 1991

Mr. **MILLER** of California (for himself, Mr. **MCDERMOTT**, and Mr. **GEJDENSON**) introduced the following bill; which was referred jointly to the Committees on Education and Labor and Ways and Means

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A BILL

To amend the Higher Education Act of 1965 to establish a higher education loan program in which the amount of a student's loan repayment is contingent upon such student's income, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. PROGRAM ESTABLISHED.

The Higher Education Act of 1965 (20 U.S.C. 1001 et seq.) is amended by inserting at the end thereof the following new title:

"TITLE XVI—SELF-RELIANCE SCHOLARSHIPS

"SEC. 1601. SHORT TITLE.

"This title may be cited as the 'Self-Reliance Scholarship Act of 1991'.

"SEC. 1602. PURPOSE.

"It is the purpose of this title to create a self-reliance scholarship program to assist students in financing their undergraduate and graduate education.

"SEC. 1603. PROGRAM AUTHORIZED.

"(a) LOAN PROGRAM ESTABLISHED.—

"(1) PROGRAM ESTABLISHED.—The Director shall carry out a program of making loans to eligible students in accordance with the provisions of this title.

"(2) ENTITLEMENT.—The Director shall make loans in accordance with the provisions of this title to each eligible student who qualifies for a loan under this title in an amount determined in accordance with section 1605(a).

"(3) CONTRACT AUTHORITY.—The Director may enter into a contract for the conduct of the program, or any portion of the program, assisted under this title.

"(b) PROGRAM REQUIREMENTS.—The program described in subsection (a) shall—

"(1) require a student who receives a loan under this title to use such loan to attend an eligible institution;

"(2) require each eligible institution that receives funds under this title to—

"(A) submit to the Director, at such time and in such form as the Director may require by regulation, a list of loan applicants and the amounts for which such applicants are qualified under section 1605; and

"(B) promptly notify the Director, on request, of any change in enrollment status of any recipient of a loan under this title; and

"(3) require the Director—

"(A) to establish an account for each recipient of a loan under this title by name and taxpayer identification number; and

"(B) provide for the increase in the total amount stated for each such account by any amounts subsequently loaned to such recipient.

"SEC. 1604. INSTITUTIONAL AGREEMENTS.

"(a) TERMS OF AGREEMENT.—In order to qualify its students for loans under this title, an eligible institution shall enter into an agreement with the Director which—

"(1) provides that the institution shall collect applications for loans under this title from its students that are in such form and contain, or are accompanied by, such information as the Director may require by regulation;

"(2) contains assurances that the institution shall, on the basis of such applications, provide to the Director the information required by section 1603(b)(2) and shall certify to the Director that each loan amount in a given year does not exceed the student's cost of attendance at such institution;

"(3) provides that the institution shall provide to each student applying for a loan under this title a notice provided by the Director of the student's obligations and responsibilities under the loan;

"(4) provides that, if a student withdraws after receiving a loan under this title and is owed a refund—

"(A) the institution shall pay to the Director for deposit into the Education Trust Fund a portion of such refund, in accordance with regulations prescribed by the Director to ensure receipt of an amount which bears the same ratio to such refund as such loan bore to the cost of attendance of such student; and

"(B) the Director shall credit the amount of such refund to the student's account;

"(5) contains assurances that the institution shall comply with the reporting requirements described in subsection (c); and

"(6) contains such additional terms and conditions as the Director and the Secretary of the Treasury prescribe by regulation to protect the fiscal interest of the United States and to ensure effective administration of the program established under this title.

"(b) ENFORCEMENT OF AGREEMENT.—The Secretary may, after notice and opportunity for a hearing to the institution concerned, suspend or revoke, in whole or in part, the agreement of any eligible institution if the Director finds that such institution has failed to comply with this title or any regulation prescribed under this title or has failed to comply with any term or condition of the agreement described in subsection (a). No funds shall be loaned under this title to any student at any eligible institution while the agreement of such institution is suspended or revoked, and the Director may institute proceedings to recover any funds held by such institution. The Director shall have the same authority with respect to functions under this title as the Secretary has with respect to his functions under part B of title IV of this Act.

"(c) REPORTS.—

"(1) CERTAIN ELIGIBLE INSTITUTIONS.—Each eligible institution entering into an agreement pursuant to subsection (a) that experiences a percentage increase in the cost of attendance at such institution which exceeds by a significant amount, as determined by the Secretary, the increase in the higher education price index, as developed by the Secretary, shall report to the Director on the increase in the cost of attendance at such institution, including a justification for such increase.

"(2) DIRECTOR.—(A) The Director, using the information received pursuant to paragraph (1), shall report to Congress on—

"(i) the reasons for excessive increases in the cost of attendance at eligible institutions; and

"(ii) whether such information should be used as a basis on which to suspend or revoke, in whole or in part, the agreement of an eligible institution.

"(B) The report described in subparagraph (A) shall be submitted to the Congress within 2 years of the date of enactment of this title.

"SEC. 1605. AMOUNT AND TERMS OF LOAN.

"(a) ELIGIBLE AMOUNTS.—

"(1) ANNUAL LIMITS.—Any individual desiring a loan under this title who is determined by an eligible institution to be an eligible student for any academic year shall receive a loan for such academic year in an amount which shall not exceed the lesser of—

"(A) $10,000, or

"(B) the greater of—

"(i) the cost of attendance at such institution, or

"(ii) $500.

"(2) LIMITATION ON BORROWING CAPACITY.—No individual may receive any amount in an additional loan under this title if the sum of the original principal amounts of all loans under this title to such individual (including the pending additional loan under this title) would exceed $33,000.

"(3) ADJUSTMENT OF LIMITS FOR INFLATION.—Each of the dollar amounts specified in paragraphs (1) and (2) shall be adjusted for any academic year beginning after calendar year 1992 by the cost-of-living adjustment for the calendar year immediately preceding such academic year determined under section 1(f)(3) of the Internal Revenue Code of 1986 by substituting '1991' for '1989'.

"(4) ADJUSTMENTS OF ANNUAL LIMITS FOR LESS THAN FULL-TIME STUDENTS.—For any eligible student who is enrolled on a less than full-time basis, loan amounts to which such student is entitled for any academic year under this subsection shall equal the cost of attendance at the eligible institution reduced in accordance with regulations prescribed by the Director.

"(b) TERMS OF LOANS.—Each eligible student applying for a loan under this title shall sign a written agreement which—

"(1) is made without security and without endorsement, except that if the borrower is a minor and such note or other written agreement executed by him would not, under the applicable law, create a binding obligation, endorsement may be required;

"(2) provides that such student shall repay such loan in accordance with the repayment provisions described in section 1607;

"(3) certifies that the student has received and read the notice required by section 1604(a)(3); and

"(4) contains such additional terms and conditions as the Director may prescribe by regulation.

"(c) DISBURSEMENT OF PROCEEDS OF LOANS.—The Director shall, by regulation, provide for the distribution of loans to eligible students and for the appropriate notification of eligible institutions of the amounts of loans which are approved for any eligible student, and for the allocation of the proceeds of such loan by semester or other portion of an academic year. The Director shall distribute the proceeds of loans under this title by disbursing to the eligible institution a check or other instrument that is payable to and requires the endorsement or other certification by the student. Such proceeds shall be credited to any obligations of the eligible student to the eligible institution related to the cost of attendance at such institution, with any excess being paid to the student.

"(d) CONSIDERATION OF OTHER STUDENT ASSISTANCE.—The amount of any loan received under this title shall not be taken into consideration in determining student eligibility for assistance pursuant to any other program assisted under this Act.

"SEC. 1606. TRUST FUND.

"(a) ESTABLISHMENT.—There is established in the Treasury of the United States a trust fund, to be known as the Education Trust Fund (hereafter in this section referred to as the 'Trust Fund'), consisting of such amounts as are transferred to the Trust Fund under subsection (b)(1) of this section, such amounts as are received pursuant to the issuance of obligations pursuant to subsection (d), and any interest earned on investment of amounts in the Trust Fund under subsection (c)(3) of this section.

"(b) TRANSFER OF AMOUNTS.—

"(1) IN GENERAL.—Subject to the limitation in paragraph (2)—

"(A) the Secretary of the Treasury shall transfer to the Trust Fund amounts equivalent to taxes received in the Treasury under sections 59B, 59C, and 59D of the Internal Revenue Code of 1986, and

"(B) the Director shall transfer to the Trust Fund refunds received pursuant to section 1604(a)(4).

"(2) TRANSFERS BASED ON ESTIMATES.—The amounts required to be transferred to the Trust Fund under paragraph (1)(A) shall be transferred at least quarterly from the general fund of the Treasury to the Trust Fund on the basis of estimates made by the Secretary of the Treasury. Proper adjustment shall be made in amounts subsequently transferred to the extent prior estimates were in excess of or less than the amounts required to be transferred.

"(c) INVESTMENT OF TRUST FUND.—

"(1) IN GENERAL.—It shall be the duty of the Secretary of the Treasury to invest such portion of the Trust Fund as is not, in the Director's judgment, required to meet current withdrawals. Such investments may be made only in interest-bearing obligations of the United States or in obligations guaranteed as to both principal and interest by the United States. For such purpose, such obligations may be acquired—

"(A) on original issue at the issue price, or

"(B) by purchase of outstanding obligations at the market price.

The purposes for which obligations of the United States may be issued under chapter 31 of title 31, United States Code, are hereby extended to authorize the issuance at par of special obligations exclusively to the Trust Fund. Such special obligations shall bear interest at a rate equal to the average rate of interest, computed as to the end of the calendar month next preceding the date of such issue, borne by all marketable interest-bearing obligations of the United States then forming a part of the Public Debt; except that where such average rate is not a multiple of one-eighth of 1 percent, the rate of interest of such special obligations shall be the multiple of one-eighth of 1 percent next lower than such average rate. Such special obligations shall be issued only if the Director determines that the purchase of other interest-bearing obligations of the United States, or of obligations guaranteed as to both principal and interest by the United States on original issue or at the market price, is not in the public interest.

"(2) SALE OF OBLIGATION.—Any obligation acquired by the Trust Fund (except special obligations issued exclusively to the Trust Fund) may be sold by the Director at the market price, and such special obligations may be redeemed at par plus accrued interest.

"(3) CREDITS TO TRUST FUND.—The interest on, and the proceeds from the sale or redemption of, any obligations held in the Trust Fund shall be credited to and form a part of the Trust Fund.

"(d) AUTHORITY TO ISSUE OBLIGATIONS.—The Trust Fund may issue bonds, notes, debentures and similar obligations in an amount not to exceed the amount of funds the Director determines necessary to carry out the provisions of this title. Such bonds, notes, debentures and similar obligations shall be issued at such time and price, in such form and at such rate of interest as the Director may prescribe.

"(e) OBLIGATIONS FROM TRUST FUND.—The Director is hereafter authorized to obligate—

"(1) such sums as are available in the Trust Fund (including any amounts not obligated in previous fiscal years) for awarding loans to eligible students in accordance with the provisions of this title;

"(2) such sums as are available in the Trust Fund to pay the principal and interest on the obligations issued under subsection (d); and

"(3) such sums as are available in the Trust Fund, as provided in appropriation Acts, for properly allocable administrative costs of the Federal Government for the activities specified above.

"(f) REPORT TO CONGRESS.—It shall be the duty of the Director to hold the Trust Fund, and to report to the Congress each year on the financial condition and the results of the operations of the Trust Fund during the preceding fiscal year and on its expected condition and operations during the next fiscal year. Such report shall be printed as both a House and Senate document of the session of the Congress to which the report is made.

"SEC. 1607. REPAYMENT PROVISIONS.

"(a) PROCEDURE.—

"(1) IN GENERAL.—The Director shall develop and implement a procedure for computing repayment percentage options for each borrower under this title.

"(2) CONTENTS.—The procedure for determining the repayment percentage described in paragraph (1) shall take into consideration the following factors:

"(A) The total amount of loans awarded to the borrower under this title and the consolidation of all loans after the date of graduation under a single repayment percentage.

"(B) The repayment percentage shall not exceed 5 percent of an individual's gross income in any year.

"(C) Borrowers with gross incomes for a taxable year of not more than 66 percent of the average gross income of individuals with college educations as determined by the Bureau of the

Census from the most recent data available shall pay a minimum repayment amount for such year equal to the borrower's repayment percentage of 66 percent of such average gross income. Borrowers with gross incomes for a taxable year of more than 150 percent of the average gross income of individuals with college educations as determined by the Bureau of the Census from the most recent data available shall pay a maximum repayment amount for such year equal to the borrower's repayment percentage of 150 percent of such average gross income.

"(D) An aggregate repayment interest rate for all individuals who borrow in an academic year under this title shall not exceed the lesser of the average of the rates of interest applicable to 10- and 30-year United States Treasury obligations for such year, or 10 percent, so that, to the extent possible, the program is self-financing.

"(E) Individuals shall be provided the option to select a 15, 20, or 25 year repayment option.

"(F) The maximum repayment period shall not exceed 25 years.

"(G) The amount of repayment interest accrued shall be taken into account if repayment is deferred by an individual beyond the first taxable year beginning after the date of the loan.

"(H) The buyout procedure described in paragraph (3).

"(3) BUYOUT PROCEDURE.—The Director shall develop a procedure under which borrowers may repay, at any time, the total amount of loans borrowed under this title. Such procedure shall include interest and a prepayment penalty.

"(b) CERTIFICATION TO THE BORROWER AND THE SECRETARY OF THE TREASURY.—

"(1) IN GENERAL.—The Director shall provide each borrower with the option to select a repayment status with a repayment percentage determined in accordance with this section and shall transmit such information along with the borrower's taxpayer identification number to the borrower and to the Secretary of the Treasury by January 1 of each calendar year.

"(2) REPAYMENT STATUS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), for purposes of paragraph (1), repayment status commences either at the start of the first taxable year following—

"(i) the date of the loan, or

"(ii) the date of graduation,

but in no event later than the sixth taxable year after the date of the loan.

"(B) EXCEPTIONS.—The Director may, by regulation, establish special repayment policies for individuals in categories of special consideration determined by the Director.

"SEC. 1608. DEFINITIONS.

"For purposes of this title—

"(1) the term 'cost of attendance' has the same meaning given to such term by section 472 of the Higher Education Act of 1965;

"(2) the term "Director" means the Director of the Office of Self-Reliance Scholarships;

"(3) the term 'eligible institution' has the meaning given such term by paragraph (1) or (2) of section 435(a) and does not include a proprietary trade school (as such term is defined in section 481(b)); and

"(4) the term 'eligible student' means a student who is a United States citizen and has attained the age of 17 years but not the age of 51 years.".

SEC. 2. COLLECTION OF LOANS.

(a) IN GENERAL.—Subchapter A of chapter 1 of the Internal Revenue Code of 1986 (relating to determination of tax liability) is amended by adding at the end thereof the following new part:

"PART VIII—EDUCATIONAL LOAN REPAYMENT TAX

"Sec. 59B. Educational loan repayment tax.

"SEC. 59B. EDUCATIONAL LOAN REPAYMENT TAX.

"(a) IN GENERAL.—Except as provided in subsection (b), in the case of an individual who receives a certification from the Director of the Office of Self-Reliance Scholarships under section 1607(b) of the Higher Education Act of 1965, there is hereby imposed (in addition to any other tax imposed by this subtitle) a tax equal to the repayment percentage (as certified by the Director) of the taxpayer's gross income for the taxable year.

"(b) MINIMUM AND MAXIMUM GROSS INCOME AMOUNTS.—

"(1) MINIMUM AMOUNT.—Subsection (a) shall be applied by substituting '66 percent of the average gross income of individuals with college educations as determined by the Bureau of the Census from the most recent data available' for 'the taxpayer's gross income for the taxable year', if the taxpayer's gross income for such year does not exceed 66 percent of such average gross income.

"(2) MAXIMUM AMOUNT.—Subsection (a) shall be applied by substituting '150 percent of the average gross income of individuals with college educations as determined by the Bureau of the Census from the most recent data available' for 'the taxpayer's gross income for the taxable year', if the taxpayer's gross income for such year exceeds 150 percent of such average gross income.

"(c) DETERMINATION OF GROSS INCOME.—

"(1) JOINT RETURN REQUIRED.—Any individual who receives a certification described in subsection (a) shall be required to file a joint return for any taxable year at the end of which such individual is married.

"(2) BASIS FOR TAX.—In the case of an individual filing a joint return for a taxable year, the tax under subsection (a) shall be determined with respect to the greater of—

"(A) the individual's gross income, or

"(B) ½ of the taxpayer's gross income.".

(b) CLERICAL AMENDMENT.—The table of parts for subchapter A of chapter 1 of such Code is amended by adding at the end thereof the following new item:

"Part VIII. Educational loan repayment tax.".

SEC 3. SURTAX ON INDIVIDUALS WITH INCOMES OVER $1,000,000.

(a) GENERAL RULE.—Subchapter A of chapter 1 of the Internal Revenue Code of 1986 (relating to determination of tax liability), as amended by section 2, is further amended by adding at the end thereof the following new part:

"PART IX—SURTAX ON INDIVIDUALS WITH INCOMES OVER $1,000,000

"Sec. 59C. Surtax on section 1 tax.
"Sec. 59D. Surtax on minimum tax.
"Sec. 59E. Special rules.

"SEC. 59C. SURTAX ON SECTION 1 TAX.

"In the case of an individual who has taxable income for the taxable year in excess of $1,000,000, the amount of the tax imposed under section 1 for such taxable year shall be increased by 10 percent of the amount which bears the same ratio to the tax imposed under section 1 (determined without regard to this section) as—

"(1) the amount by which the taxable income of such individual for such taxable year exceeds $1,000,000, bears to

"(2) the total amount of such individual's taxable income for such taxable year.

"SEC. 59D. SURTAX ON MINIMUM TAX.

"In the case of an individual who has alternative minimum taxable income for the taxable year in excess of $1,000,000, the amount of the tentative minimum tax determined under section 55 for such taxable year shall be increased by 2.5 percent of the amount by which the alternative minimum taxable income of such taxpayer for the taxable year exceeds $1,000,000.

"SEC. 59E. SPECIAL RULES.

"(a) SURTAX TO APPLY TO ESTATES AND TRUSTS.—For purposes of this part, the term 'individual' includes any estate or trust taxable under section 1.

"(b) TREATMENT OF MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—In the case of a married individual (within the meaning of section 7703) filing a separate return for the taxable year, sections 59C and 59D shall be applied by substituting '$500,000' for '$1,000,000'.

"(c) COORDINATION WITH OTHER PROVISIONS.—The provisions of this part—

"(1) shall be applied after the application of section 1(h), but

"(2) before the application of any other provision of this title which refers to the amount of tax imposed by section 1 or 55, as the case may be.".

(b) CLERICAL AMENDMENT.—The table of parts for subchapter A of chapter 1 of the Internal Revenue Code of 1986 is amended by adding at the end the following new item:

"Part IX. Surtax on individuals with incomes over $1,000,000.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 1991.

SEC. 4. OFFICE OF SELF-RELIANCE SCHOLARSHIPS ESTABLISHED.

Title II of the Department of Education Organization Act is amended by inserting at the end thereof the following new section:

"OFFICE OF SELF-RELIANCE SCHOLARSHIPS

"SEC. 214. There shall be in the Department an Office of Self-Reliance Scholarships, to be administered by the Director of the Office of Self-Reliance Scholarships. The Director shall be responsible for overseeing the Self-Reliance Scholarship Act.".

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102d CONGRESS
1st Session

H. R. 2336

To establish a higher education loan program in which a borrower's annual repayment obligation is dependent upon both postschool income level and borrowing history, and for other purposes.

IN THE HOUSE OF REPRESENTATIVES

May 14, 1991

Mr. Petri (for himself, Mr. Gejdenson, Ms. Molinari, Mr. Inhofe, Mr. Santorum, Mr. Porter, Mr. LaFalce, Mr. Lancaster, Mr. Sundquist, Mr. Nussle, Mr. Horton, Mr. McCollum, Mr. Hughes, Mr. Hertel, Mr. Campbell of Colorado, and Mr. de Lugo) introduced the following bill; which was referred jointly to the Committees on Education and Labor and Ways and Means

---

A BILL

To establish a higher education loan program in which a borrower's annual repayment obligation is dependent upon both postschool income level and borrowing history, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Income-Dependent Education Assistance Act of 1991".

TITLE I—SYSTEM FOR MAKING INCOME-DEPENDENT EDUCATION ASSISTANCE LOANS

SEC. 101. PROGRAM AUTHORITY.

The Secretary of the Treasury shall, in accordance with the provisions of this title—

(1) make loans to eligible students in accordance with this title, and

(2) establish an account for each borrower of such a loan, and collect repayments on such loans, in accordance with section 6306 of the Internal Revenue Code of 1986.

SEC. 102. AGREEMENTS BY ELIGIBLE INSTITUTIONS.

(a) TERMS OF AGREEMENT.—In order to qualify its students for loans under this title, an eligible institution shall enter into an agreement with the Secretary of Education which—

(1) provides that the institution will collect applications for loans under this title from its students that are in such form and contain or are accompanied by such information as the Secretary of the Treasury may require by regulation;

(2) contains assurances that the institution will, on the basis of such applications, provide to the Secretary of the Treasury the information required by

section 104 and will certify to the Secretary of the Treasury—

(A) the cost of attendance determination for each student; and

(B) the amount of any outstanding loans to such student under title IV of the Higher Education Act of 1965 or title VII of the Public Health Service Act;

(3) provides that the institution will provide to each student applying for a loan under this title a notice provided by the Secretary of Education of the student's obligations and responsibilities under the loan;

(4) provides that, if a student withdraws after receiving a loan under this title and is owed a refund—

(A) the institution will pay to the Secretary of the Treasury a portion of such refund, in accordance with regulations prescribed by the Secretary of the Treasury to ensure receipt of an amount which bears the same ratio to such refund as such loan bore to the cost of attendance of such student; and

(B) the Secretary of the Treasury will credit the amount of such refund to the student's account; and

(5) contains such additional terms and conditions as the Secretary of the Treasury or Secretary of Education prescribes by regulation to protect the fiscal interest of the United States and to ensure effective administration of the program under this Act.

(b) ENFORCEMENT OF AGREEMENT.—The Secretary of Education may, after notice and opportunity for a hearing to the institution concerned, suspend or revoke, in whole or in part, the agreement of any eligible institution if the Secretary of Education finds that such institution has failed to comply with this title or any regulation prescribed under this title or has failed to comply with any term or condition of its agreement under subsection (a). No funds shall be loaned under this title to any student at any institution while its agreement is suspended or revoked, and the Secretary of Education may institute proceedings to recover any funds held by such an institution. The Secretary of Education shall have the same authority with respect to his functions under this Act as the Secretary of Education has with respect to his functions under part B of title IV of the Higher Education Act of 1965.

(c) NOTICE TO SECRETARY.—The Secretary of Education shall annually submit to the Secretary of the Treasury a list of the eligible institutions having effective agreements under this section, and shall promptly notify the Secretary of the Treasury of any action taken under subsection (b) to suspend, revoke, or reinstate any such agreement.

SEC. 103. AMOUNT AND TERMS OF LOANS.

(a) ELIGIBLE AMOUNTS.—

(1) ANNUAL LIMITS.—Any individual who is determined by an eligible institution to be an eligible student for any academic year shall be eligible to receive an IDEA loan for such academic year in an amount which is not less than $500 or more than the cost of attendance at such institution, determined in accordance with section 484 of the Higher Education Act of 1965. The amount of such loan shall not exceed—

(A) $6,500 in the case of any student who has not completed his or her second year of undergraduate study;

(B) $8,000 in the case of any student who has completed such second year but who has not completed his or her course of undergraduate study;

(C) $30,000 in the case of any student who is enrolled in a graduate degree program in medicine, dentistry, veterinary medicine, podiatry, optometry, or osteopathic medicine; or

(D) $22,500 in the case of any student who is enrolled in a graduate degree program in pharmacy, chiropractic, public health, health administration, clinical psychology, or allied health fields, or in an undergraduate degree program in pharmacy; or

(E) $11,000 in the case of any other student.

(2) LIMITATION ON BORROWING CAPACITY.—No individual may receive any amount in an additional IDEA loan if the sum of the original principal amounts of all IDEA loans to such individual (including the pending additional loan) would equal or exceed—

(A) $70,000, minus

(B) the product of (i) the number of years by which the borrower's age (as of the close of the preceding calendar year) exceeds 35, and (ii) one-twentieth of the amount specified in subparagraph (A), as adjusted pursuant to paragraph (3).

(3) EXCEPTIONS TO BORROWING CAPACITY LIMITS FOR CERTAIN GRADUATE STUDENTS.—For a student who is—

(A) a student described in paragraph (1)(C), paragraph (2) shall be applied by substituting "$143,370" for "$70,000"; or

(B) a student described in paragraph (1)(D), paragraph (2) shall be applied by substituting "$115,770" for "$70,000".

(4) ADJUSTMENT OF LIMITS FOR INFLATION.—Each of the dollar amounts specified in paragraphs (1), (2), and (3) shall be adjusted for any academic year after calendar year 1994 by the cost-of-living adjustment for the calendar year preceding such academic year determined under section 6306(h)(3)(C) of the Internal Revenue Code of 1986, rounded to the nearest multiple of $100 (or, if such adjustment is a multiple of $50 and not a multiple of $100, such adjustment shall be increased to the next higher multiple of $100).

(5) COMPUTATION OF OUTSTANDING LOAN OBLIGATIONS.—For the purposes of this subsection, any loan obligations of an individual under student loan programs under title IV of the Higher Education Act of 1965 or title VII of the Public Health

Service Act shall be counted toward IDEA annual and aggregate borrowing capacity limits. For purposes of annual and aggregate loan limits under any such student loan program, IDEA loans shall be counted as loans under such program.

(6) ADJUSTMENTS OF ANNUAL LIMITS FOR LESS THAN FULL-TIME STUDENTS.—For any student who is enrolled on a less than full-time basis, loan amounts for which such student shall be eligible for any academic year under this subsection shall be reduced in accordance with regulations prescribed by the Secretary of Education.

(b) DURATION OF ELIGIBILITY.—An eligible student shall not be eligible to receive a loan under this title for more than a total of the full-time equivalent of 9 academic years, of which not more than the full-time equivalent of 5 academic years shall be as an undergraduate student and not more than the full-time equivalent of 5 academic years shall be as a graduate student.

(c) TERMS OF LOANS.—Each eligible student applying for a loan under this title shall sign a written agreement which—

(1) is made without security and without endorsement, except that if the borrower is a minor and such note or other written agreement executed

by him would not, under the applicable law, create a binding obligation, endorsement may be required,

(2) provides that such student will repay the principal amount of the loan and any interest or additional charges thereon in accordance with section 6306 of the Internal Revenue Code of 1954;

(3) provides that the interest on the loan will accrue in accordance with section 105;

(4) certifies that the student has received and read the notice required by section 102(a)(3); and

(5) contains such additional terms and conditions as the Secretary of the Treasury may prescribe by regulation.

(d) DISBURSEMENT OF PROCEEDS OF LOANS.—The Secretary of the Treasury shall, by regulation, provide for the distribution of loans to eligible students and for the appropriate notification of eligible institutions of the amounts of loans which are approved for any eligible student, and for the allocation of the proceeds of such loan by semester or other portion of an academic year. The Secretary of the Treasury shall distribute the proceeds of loans under this title by disbursing to the institution a check or other instrument that is payable to and requires the endorsement or other certification by the student. Such proceeds shall be credited to any obligations of the eligible student to the institution related to the cost of attendance at such institution, with any excess being paid to the student. The first installment of the proceeds of any loan under this title that is made to a student borrower who is entering the first year of a program of undergraduate education, and who has not previously obtained a loan under this title, shall not be presented by the institution to the student for endorsement until 30 days after the borrower begins a course of study, but may be delivered to the eligible institution prior to the end of that 30-day period.

SEC. 104. INFORMATION REQUIREMENTS FOR LOAN PROGRAM.

(a) Responsibilities of Eligible Institutions.—Each eligible institution which receives funds under this title shall—

(1) submit to the Secretary of the Treasury, at such time and in such form as the Secretary may require by regulation, a machine-readable list of applicants and the amounts for which they are qualified under section 103;

(2) promptly notify the Secretary of the Treasury, on request, of any change in enrollment status of any recipient of a loan under this title; and

(3) submit to the Secretary of the Treasury, at such time and in such forms as the Secretary of the Treasury may require by regulation for use in determining the repayment status of borrowers, a machine-readable list of eligible students who have previously received loans under this title but who are not included as current applicants in the list required by such paragraph.

(b) RESPONSIBILITIES OF THE SECRETARY OF THE TREASURY.—The Secretary of the Treasury shall, on the basis of the lists received under subsection (a)(2), establish an obligation account, by name and taxpayer identification number, with respect to each recipient of a loan under this title. The Secretary of the Treasury shall provide for the increase in the total amount stated for each such account by any amounts subsequently loaned to that recipient under this title and by the amount of any interest charges imposed pursuant to section 105. The Secretary of the Treasury shall, with the notice required by section 6306(a)(1) of the Internal Revenue Code of 1986, transmit to each recipient of a loan under this title a statement of the total amount of the obligation of such recipient as of the close of the preceding calendar year.

SEC. 105. INTEREST CHARGES.

Interest charges on loans made under this title shall be added to the recipient's obligation account at the end of each calendar year. Such interest charges shall be based upon an interest rate equal to the lesser of—

(1) the sum of the average bond equivalent rates of 91-day Treasury bills auctioned during that calendar year, plus 2 percentage points, rounded to the next higher one-eighth of 1 percent; or

(2) 10 percent.

SEC. 106. CONVERSION AND CONSOLIDATION OF OTHER LOANS.

(a) IN GENERAL.—The Secretary of the Treasury may, upon request of a borrower who has received a federally insured or guaranteed loan or loans under title IV of the Higher Education Act of 1965 or under title VII of the Public Health Service Act, make a new loan to such borrower in an amount equal to the sum of the unpaid principal on the title IV or title VII loans. The proceeds of the new loan shall be used to discharge the liability on such title IV or title VII loans. Except as provided in subsection (b), any loan made under this subsection shall be made on the same terms and conditions as any other loan under this Act and shall be considered a new IDEA loan for purposes of this title and section 6306 of the Internal Revenue Code of 1986.

(b) CONVERSION REGULATIONS.—The Secretary of the Treasury shall prescribe regulations concerning the methods and calculations required for conversion to IDEA loans under subsection (a). Such regulations shall provide appropriate adjustments in the determination of the principal and interest owed on the IDEA loan in order to—

(1) secure payments to the Government commensurate with the amounts the Government would have received had the original loans been IDEA loans;

(2) fairly credit the borrower for principal and interest payments made on such original loans and for origination fees deducted from such original loans; and

(3) prevent borrowers from evading their obligations or otherwise taking unfair advantage of the conversion option provided under this section.

(c) MANDATORY CONVERSION OF DEFAULTED LOANS.—

(1) CONVERSION IN ACCORDANCE WITH REGULATIONS.—Any loan which is—

(A) made, insured, or guaranteed under title IV of the Higher Education Act of 1965 or title VII of the Public Health Service Act after the date of enactment of this Act, and

(B) assigned to the Secretary of Education or Health and Human Services for collection after a default by the borrower in repayment of such loan,

shall, in accordance with regulations prescribed by the Secretaries of Education and Health and Human Services, be treated for purposes of collection, under section 6306 of the Internal Revenue Code of 1986, as if such loan had been converted to an IDEA loan under subsections (a) and (b) of this section.

(2) NOTICES.—The Secretaries of Education and Health and Human Services shall notify—

(A) the Secretary of the Treasury of the need to establish or adjust an account balance of any borrower by reason of the provisions of this subsection; and

(B) the borrower of the conversion of the defaulted loans to an IDEA loan and of the procedures for collection under section 6306 of the Internal Revenue Code of 1986.

SEC. 107. TERMINATION OF OTHER STUDENT LOAN PROGRAMS.

The authority to make additional loans under section 428A and part D of title IV of the Higher Education Act of 1965 (20 U.S.C. 1078–1) is terminated for any academic year beginning after the date that regulations are prescribed by the Secretaries of the Treasury and Education to carry out this title. This section shall not affect the administration of such section and part with respect to loans made prior to that date.

SEC. 108. AUTHORIZATION OF APPROPRIATIONS.

(a) LOAN FUNDS.—There are authorized to be appropriated to make distributions of loan funds under section 102 such sums as may be necessary.

(b) ADMINISTRATIVE EXPENSES.—There are authorized to be appropriated such sums as may be necessary to administer and carry out this title.

SEC. 109. DEFINITIONS.

For purposes of this title—

(1) the term "eligible institution" has the meaning given it by section 435(a) (1) or (2) of the Higher Education Act of 1965;

(2) the term "eligible student" means a student who is eligible for assistance under title IV of the Higher Education Act of 1965 as required by section 484 of such Act (relating to eligibility for student assistance) and who is carrying at least one-half the normal full-time academic workload (as determined by the institution); and

(3) the term "IDEA loan" means a loan made under this title.

TITLE II—COLLECTION OF INCOME-DEPENDENT EDUCATION ASSISTANCE LOANS

SEC. 201. REPAYMENTS USING INCOME TAX COLLECTION SYSTEM.

(a) IN GENERAL.—Subchapter A of chapter 64 of the Internal Revenue Code of 1986 (relating to collection) is amended by adding at the end thereof the following new section:

"SEC. 6306. COLLECTION OF INCOME-DEPENDENT EDUCATION ASSISTANCE LOANS.

"(a) NOTICE TO BORROWER.—

"(1) IN GENERAL.—During January of each calendar year, the Secretary shall furnish to each borrower of an IDEA loan notice as to—

"(A) whether the records of the Secretary indicate that such borrower is in repayment status,

"(B) the maximum account balance of such borrower,

"(C) the current account balance of such borrower as of the close of the preceding calendar year, and

"(D) the procedure for computing the amount of repayment owing for the taxable year beginning in the preceding calendar year.

"(2) FORM, ETC.—The notice under paragraph (1) shall be in such form as the Secretary may by regulations prescribe and shall be sent by mail to the individual's last known address or shall be left at the dwelling or usual place of business of such individual.

"(b) COMPUTATION OF ANNUAL REPAYMENT AMOUNT.—

"(1) IN GENERAL.—The annual amount payable under this section by the taxpayer for any taxable year shall be the lesser of—

"(A) the product of—

"(i) the base amortization amount, and

"(ii) the progressivity factor for the taxpayer for such taxable year, or

"(B) 20 percent of the excess of—

"(i) the modified adjusted gross income of the taxpayer for such taxable year, over

"(ii)(I) in the case of a joint return, the sum of the standard deduction applicable to such return and twice the exemption amount for the taxable year, and

"(II) in any other case, the sum of the standard deduction applicable to such individual and the exemption amount for the taxable year.

For purposes of subparagraph (B)(ii), the term 'standard deduction' has the meaning given such term by section 63(c), and the term 'exemption amount' has the meaning given such term by section 151(d).

"(2) BASE AMORTIZATION AMOUNT.—

"(A) IN GENERAL.—For purposes of this section, the term 'base amortization amount' means the amount which, if paid at the close of each year for a period of 12 consecutive years, would fully repay (with interest) at the close of such period the maximum account balance of the borrower. For purposes of the preceding sentence, an 8-percent annual rate of interest shall be assumed.

"(B) JOINT RETURNS.—In the case of a joint return where each spouse has an account balance and is in repayment status, the amount determined under subparagraph (A) shall be the sum of the base amortization amounts of each spouse.

“(3) PROGRESSIVITY FACTOR.—

“(A) IN GENERAL.—For purposes of this section, the term ‘progressivity factor’ means the number determined under tables prescribed by the Secretary which is based on the following tables for the circumstances specified:

“(i) JOINT RETURNS; SURVIVING SPOUSES.—In the case of a taxpayer to whom section 1(a) applies—

“If the taxpayer's modified adjusted gross income is:	**The progressivity factor is:**
Not over $7,860	0.429
11,700	0.500
16,740	0.571
21,720	0.643
26,880	0.786
32,700	0.893
39,060	1.000
48,600	1.000
63,480	1.152
87,360	1.272
117,000	1.364
163,080	1.485
240,000 and over	2.000

“(ii) HEADS OF HOUSEHOLDS.—In the case of a taxpayer to whom section 1(b) applies—

“If the taxpayer's modified adjusted gross income is:	**The progressivity factor is:**
Not over $6,540	0.429
10,320	0.500
12,300	0.607
16,080	0.643
19,920	0.714
25,020	0.857
31,380	1.000

37,740	1.000
47,280	1.094
63,180	1.313
85,440	1.406
114,060	1.500
204,000 and over	2.000

"(iii) UNMARRIED INDIVIDUALS, ETC.—In the case of a taxpayer to whom section 1(c) applies—

"If the taxpayer's modified adjusted gross income is:	The progressivity factor is:
Not over $6,540	0.467
9,000	0.500
11,580	0.533
14,220	0.600
16,740	0.667
19,920	0.767
25,020	0.867
31,380	1.000
37,740	1.000
45,360	1.118
58,080	1.235
82,260	1.412
94,320	1.500
168,000 and over	2.000

"(iv) MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—In the case of a taxpayer to whom section 1(d) applies—

"If the taxpayer's modified adjusted gross income is:	The progressivity factor is:
Not over $3,930	0.483
5,850	0.552
8,370	0.655
10,860	0.759
13,440	0.862
16,350	1.000
19,530	1.000
24,300	1.182
31,740	1.333
43,680	1.485
84,000 and over	2.000

"(B) RATABLE CHANGES.—The tables prescribed by the Secretary under subparagraph

(A) shall provide for ratable increases (rounded to the nearest 1/1,000) in the progressivity factors between the amounts of modified adjusted gross income contained in the tables.

"(C) INFLATION ADJUSTMENT OF MODIFIED AGI AMOUNTS.—For inflation adjustment of amounts of modified adjusted gross income, see subsection (h)(3).

"(4) MODIFIED ADJUSTED GROSS INCOME.—For purposes of this subsection, the term 'modified adjusted gross income' means adjusted gross income for the taxable year—

"(A) determined without regard to section 62(b) and without regard to the deductions from gross income allowable under section 62(a) by reason of—

"(i) paragraph (6) thereof (relating to profit-sharing, annuities, and bond-purchase plans of self-employed individuals),

"(ii) paragraph (7) thereof (relating to retirement savings), and

"(iii) paragraph (11) thereof (relating to reforestation expenses), and

"(B) increased by—

"(i) interest exempt from the tax imposed by chapter 1, and

"(ii) the items of tax preference described in section 57 (other than subsection (a)(5) thereof).

"(c) TERMINATION OF BORROWER'S REPAYMENT OBLIGATION.—

"(1) IN GENERAL.—The repayment obligation of a borrower of an IDEA loan shall terminate only if there is repaid with respect to such loan an amount equal to—

"(A) in the case of any repayment during the first 12 years for which the borrower is in repayment status with respect to any loan, the sum of—

"(i) the principal amount of the loan, plus

"(ii) interest computed for each year the loan is outstanding at an annual rate equal to the annual rate otherwise applicable to such loan for such year, plus 2.5 percent, and

"(B) in the case of any repayment during any subsequent year, the principal amount of the loan plus interest computed at the rates applicable to the loan.

"(2) NO REPAYMENT REQUIRED AFTER 25 YEARS IN REPAYMENT STATUS.—No amount shall be required to be repaid under this section with respect to any loan for any taxable year after the 25th year for which the borrower is in repayment status with respect to such loan.

"(3) EXCEPTION FOR DE MINIMUS LOANS REPAID DURING FIRST 12 YEARS IN REPAYMENT STATUS.—In any case where the maximum account balance of any borrower is $3,000 or less, subparagraph (B), and not subparagraph (A), of paragraph (1) shall apply to repayment of such loan.

"(4) DETERMINATION OF YEARS IN REPAYMENT STATUS.—For purposes of paragraphs (1)(A) and (2), the number of years in which a borrower is in repayment status with respect to any IDEA loan shall be determined without regard to any year before the most recent year in which the borrower received an IDEA loan.

"(5) EXTENSION OF REPAYMENT YEARS FOR MEDICAL INTERNS.—The number of years specified in paragraphs (1)(A) and (2) shall be increased by 1 year for each calendar year during any 5 months of which the individual is an intern in medicine, dentistry, veterinary medicine, or osteopathic medicine.

"(d) DEFINITIONS.—For purposes of this section—

"(1) MAXIMUM ACCOUNT BALANCE.—The term 'maximum account balance' means the highest amount (as of the close of any calendar year) of unpaid principal and unpaid accrued interest on all IDEA loan obligations of a borrower.

"(2) CURRENT ACCOUNT BALANCE.—The term 'current account balance' means the amount (as of the close of a calendar year) of unpaid principal and unpaid accrued interest on all IDEA loans of a borrower.

"(3) REPAYMENT STATUS.—A borrower is in repayment status for any taxable year unless—

"(A) such borrower was, during at least 7 months of such year, an eligible student, as that term is defined in section 109(3) of the Income-Dependent Education Assistance Act of 1991; or

"(B) such taxable year was the first year in which the borrower was such an eligible student and the borrower was such an eligible student during the last 3 months of such taxable year.

"(4) IDEA LOAN.—The term 'IDEA loan' means any loan made under title I of the Income-Dependent Education Assistance Act of 1991.

"(e) PAYMENT OF AMOUNT OWING.—Any amount to be collected from an individual under this section shall be paid—

"(1) not later than the last date (determined without regard to extensions) prescribed for filing his return of tax imposed by chapter 1 for the taxable year ending before the date the notice under subsection (a) is sent, and

"(2)(A) if such return is filed not later than such date, with such return, or

"(B) in any case not described in subparagraph (A), in such manner as the Secretary may by regulations prescribe.

"(f) FAILURE TO PAY AMOUNT OWING.—If an individual fails to pay the full amount required to be paid on or before the last date described in subsection (e)(1), the Secretary shall assess and collect the unpaid amount in the same manner, with the same powers, and subject to the same limitations applicable to a tax imposed by subtitle C the collection of which would be jeopardized by delay.

"(g) Loans of Deceased and Permanently Disabled Borrowers; Discharge by Secretary.—

"(1) Discharge in the event of death.—If a borrower of an IDEA loan dies or becomes permanently and totally disabled (as determined in accordance with regulations of the Secretary), then the Secretary shall discharge the borrower's liability on the loan.

"(2) Limitation on discharge.—The discharge of the liability of an individual under this subsection shall not discharge the liability of any spouse with respect to any IDEA loan made to such spouse.

"(h) Crediting of Collections; Special Rules.—

"(1) Crediting of amounts paid on a joint return.—Amounts collected under this section on a joint return from a husband and wife both of whom are in repayment status shall be credited to the accounts of such spouses in the following order:

"(A) first, to repayment of interest added to each account at the end of the preceding calendar year in proportion to the interest so added to the respective accounts of the spouses, and

"(B) then, to repayment of unpaid principal, and unpaid interest accrued before such preceding calendar year, in proportion to the respective maximum account balances of the spouses.

"(2) COMPUTATION OF ALTERNATIVE ANNUAL PAYMENT FOR INDIVIDUALS WHO HAVE ATTAINED AGE 55.—In the case of an individual who attains age 55 before the close of the calendar year ending in the taxable year, or of an individual filing a joint return whose spouse attains age 55 before the close of such calendar year, the progressivity factor applicable to the base amortization amount of such individual for such taxable year shall not be less than 1.0.

"(3) INFLATION ADJUSTMENT IN COMPUTATION OF PROGRESSIVITY FACTOR.—

"(A) IN GENERAL.—Not later than December 15 of 1996 and of each 3d calendar year thereafter, the Secretary shall prescribe tables which shall apply in lieu of the tables contained in subsection (b)(3)(A) with respect to the succeeding 3 calendar years.

"(B) METHOD OF PRESCRIBING TABLES.—The table which under subparagraph (A) is to apply in lieu of the table contained in clause (i), (ii), (iii), or (iv) of subsection (b)(3)(A), as the case may be, shall be prescribed—

"(i) by increasing each amount of modified adjusted gross income in such table by the cost-of-living adjustment for the calendar year, and

"(ii) by not changing the progressivity factor applicable to the modified adjusted gross income as adjusted under clause (i).

If any increase under the preceding sentence is not a multiple of $10, such increase shall be rounded to the nearest multiple of $10 (or, if such increase is a multiple of $5 and is not a multiple of $10, such increase shall be increased to the next highest multiple of $10).

"(C) COST-OF-LIVING ADJUSTMENT.—For purposes of this paragraph, the cost-of-living adjustment for any calendar year is the percentage (if any) by which—

"(i) the CPI for the preceding calendar year, exceeds

"(ii) the CPI for the calendar year 1995.

"(D) CPI FOR ANY CALENDAR YEAR.—For purposes of subparagraph (C), the CPI for any calendar year is the average of the Consumer Price Index as of the close of the 12-month period ending on September 30 of such calendar year.

"(E) CONSUMER PRICE INDEX.—For purposes of subparagraph (D), the term 'Consumer Price Index' means the last Consumer Price Index for all-urban consumers published by the Department of Labor.

"(5) RULES RELATING TO BANKRUPTCY.—

"(A) IN GENERAL.—An IDEA loan shall not be dischargeable in a case under title 11 of the United States Code.

"(B) CERTAIN AMOUNTS MAY BE POSTPONED.—If any individual receives a discharge in a case under title 11 of the United States Code, the Secretary may postpone any amount of the portion of the liability of such individual on any IDEA loan which is attributable to amounts required to be paid on such loan for periods preceding the date of such discharge.

"(6) FINALITY OF ASSESSMENT AND COLLECTION.—The first sentence of subsection (b) of section 6305 shall apply to assessments and collections under subsection (f) of this section."

(b) APPLICATION OF ESTIMATED TAX.—Subsection (f) of section 6654 of such Code (relating to failure by individual to pay estimated income tax) is amended by striking "minus" at the end of paragraph (2) and inserting "plus", by redesignating paragraph (3) as paragraph (4), and by inserting after paragraph (2) the following new paragraph:

"(3) the amount required to be repaid under section 6306 (relating to collection of income-dependent education assistance loans), minus."

(c) FILING REQUIREMENT.—Subsection (a) of section 6012 of such Code (relating to persons required to make returns of income) is amended by inserting after paragraph (9) the following new paragraph:

"(10) Every individual required to make a payment for the taxable year under section 6306 (relating to collection of income-dependent education assistance loans)."

(d) CLERICAL AMENDMENT.—The table of sections for subchapter A of chapter 64 of such Code is amended by adding at the end thereof the following new item:

"Sec. 6306. Collection of income-dependent education assistance loans."

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